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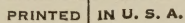
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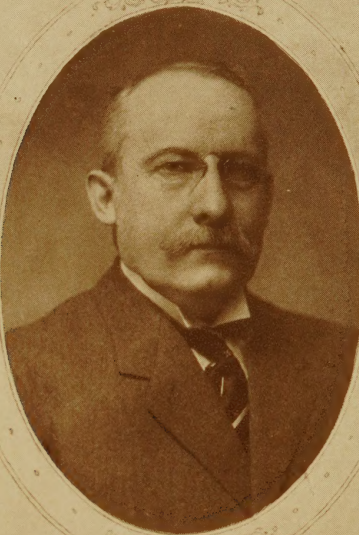
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JAMES G. CANNON

President of the Fourth National Bank, New
York, First President of the National Ass'n of
Credit Men

THE AMERICAN BUSINESS MANUAL

A COMPLETE GUIDE TO
MODERN SYSTEMS
AND PRACTISE

EDITED BY

ROBERT H. MONTGOMERY
OF LYBRAND, ROSS BROS. & MONTGOMERY
CERTIFIED PUBLIC ACCOUNTANTS
EDITOR AMERICAN EDITION
DICKSEE'S AUDITING

VOLUME THREE ADMINISTRATION

WITH INTRODUCTION BY

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OF CREDIT MEN

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INTRODUCTION

THE GRANTING OF CREDIT

BY JAMES G. CANNON

What is credit? The term "credit" is derived from the Latin word *credo* (I believe) and its opposite word "debt" from *debeo* (I owe); and there can be no debt without credit and no credit without debt. The word implies the belief of one of the parties to a transaction in a promise made by the other and an obligation acknowledged by one party as due to the other. "The Century Dictionary" defines credit as—"Trust; confidence reposed in the ability and intention of a purchaser (of merchandise, or a borrower of money) to make payments at some future time either specified or indefinite."

Some one has said "credit is to business what mortar is to a wall; it is the adhesive material with which commerce is cemented." For the most part we buy and sell merchandise, agricultural products, stocks and bonds, real estate, and everything that can be bought and sold, not for money paid down, but with promises to pay money at some future date.

The money of the country has been likened to the blood that circulates through the body; but as it has been demonstrated that over 90 per cent of the business of the country is done through the medium of credits, I should liken credit to the body itself, and whatever conduces to its growth and development will to that extent build up and strengthen commerce.

The humblest citizen, as well as the greatest manufacturer, feels the power and recognizes the influence of credit. Credit enters into the life of every business man

in this country. The rapid development of this country is largely due to the liberality with which, for many years, credit has been granted, furnishing the bold, aggressive business men with means to accomplish results which otherwise they could not have reached.

There are very few large or reputable concerns doing business to-day without borrowing, and I am unable to recall more than one or two instances of a firm or company of any prominence which does not borrow directly, or use its credit in some other way. There may possibly be a few concerns in the country whose surplus is so large that they find it unnecessary to use their credit, but such cases are rare exceptions.

Credit is indispensable; and whether it be given in the way of money or merchandise, it augments the public wealth, advances the prosperity of the country, and insures progress so long as it is given judiciously and wisely. On the other hand, if it be extended to persons who are unworthy or who become embarrassed because of their lack of character, ability, honesty, or capital, the result is extremely detrimental.

Some one has truly said that "credit never knocks at the door of the indolent, never lingers under the shadow of indecision, never smiles on good intentions that are barren of results."

Credit oftentimes becomes too cheap and is too readily obtained. As a result, a period of inflation follows until the bubble bursts and a panic ensues, which is disastrous alike to debtor and creditor. All dispensers of credit, therefore, should be particular to bear in mind that it is highly desirable to curb the spirit of overtrading, the results of which are injurious not only to banks but to those who seek favor at the banker's hands.

The principles of Scientific Credit to-day are:

1. To reduce losses.
2. To eliminate disproportionate risks.
3. To conserve worthy interests.
4. To war on dishonesty and incompetence.

Never in the history of American commerce has there been such close scrutiny of credits as is now being made;

and I believe one of the reasons is that a new factor has appeared in business circles in the shape of industrial and commercial corporations as applicants for credit. The personal and friendly element existing between debtor and creditor is eliminated, and corporations (said to have no souls) are rapidly being organized in place of partnerships. Thus the question of family prestige and the protection of a family name are fast ceasing to be factors. Men who would struggle to maintain their family honor and keep their family name from records of the bankruptcy court, as stockholders and managers of corporations have not the same incentives to pay their debts one hundred cents on the dollar. The history of our country is replete with instances of men compelled to succumb to disaster, who, later on, achieved financial success and proudly paid their indebtedness, principal and interest. Men who own or mainly own and control corporations that fail have no need to fight for their family honor. Instead, they pose before the public as unfortunate investors in a disastrous enterprise, claiming sympathy for their losses, with no thought that there rests upon them an honorable obligation to satisfy the corporation's creditors out of any funds that fortune in the future may enable them to accumulate. Personal credit and personal honor thus screen themselves behind joint-stock companies and corporations; and the giver of credit is subjected to greater labor and is compelled to scrutinize more closely in order to protect himself from loss.

As time goes on, the margin of profit in all lines of business seems to be constantly narrowing; and in view of this condition of affairs, we all find that we can not afford to stand the losses we formerly sustained through failures; consequently, the lines must be closely drawn and every precaution possible taken to eliminate those concerns that are unworthy of credit and whose existence constitutes a standing menace to reputable and legitimate business enterprises.

To extend credit properly and safely requires the highest exercise of mental powers, for many complex questions are to be solved, and oftentimes the credit

man is called upon to make investigations which are both delicate and intricate in their nature,

In considering the responsibility of a borrower, it would seem that his total net worth should be first ascertained. If the amount of money which he has invested in the business is small, and he is likely to be a large borrower, his credit should be based proportionately.

We should also consider his record and standing in the community as a merchant. Has he ever failed? If so, what were the circumstances? What are his habits in private life? What settlement did he make with his creditors? Is he extravagant—does he live beyond his means? Is he a gambler, a speculator, or is there anything that would lead him to spend more money than he can safely take from his business?

We should also look into his business record. Does he pay his bills promptly, and how does he stand in the trade which he represents? These points, it seems to me, should define the line of credit to be granted.

We should also consider his claims to credit. What are the characteristics of the borrower? Has he ability? Has he a reputation for honesty? Does he show that his business is prosperous? Is he up and abreast with the modern methods of transacting business, or is his business on the down grade? And finally, what is his present financial condition? This should be gathered from a statement over his signature, giving in detail his assets and liabilities.

The fundamental basis of all credit should be a signed statement. It is conceded by all that the applicant for credit can give better information about himself than can any of his friends or competitors. First-hand information is always preferable. While to some extent it is necessary to do business on faith, yet facts, if obtainable, will stand us in better stead. If the credit-man depends upon indefinite and hearsay information, making that the basis for credit, he has only himself to blame when a loss is the result; but if, on the other hand, he has sought and obtained a full detailed signed statement, and has carefully analyzed, weighed, and verified it, so far as lies

within his power, by systematic investigation, he will have the satisfaction of knowing that he did everything he could to estimate the risk correctly, and no blame can attach to him.

The use of such statements by banks has had a very salutary effect, and we find that people are more ready now than ever before to give statements. All reforms in every line of business meet with more or less opposition at the start, and this one has met its share. Old houses that have been in the habit of conducting their business without revealing the particulars of their affairs, sometimes feel a natural reluctance to making a statement of their condition; but this feeling is gradually passing away, and my conviction is, that the time is not far distant when a firm or corporation refusing to give a statement of its financial condition will not be granted any accommodation.

Modern commercial firms can not exist without borrowing; and if their financial condition and their balances at bank warrant them in asking for funds, they are entitled, as a matter of commercial custom, to the money, and the whole matter of borrowing is thus placed upon a business basis and does not depend merely upon favoritism.

When a statement is received it should be carefully analyzed. It is especially desirable to investigate the personal record and character of the would-be debtor, for, after all, everything depends upon his honesty. The Psalmist says: "The righteous is very merciful, and lendeth; the ungodly borroweth and payeth not again," and the truth of this verse of the Scripture is fully exemplified in this later generation. The sacred writer also says, "The borrower is servant to the lender"; but sometimes it seems as if this were reversed, as many borrowers assume a position where they believe themselves masters of those from whom they obtain credit.

In investigating the honesty of an applicant for credit, it is always better to find out in an indirect way his idea of what constitutes honesty. Another point which should receive attention is a man's ability; also the circum-

stances under which he started business life—whether he made his money by his own efforts, or if it came to him through the assistance of his friends or relatives, or by inheritance.

A statement should show how much merchandise a concern carries, what its indebtedness is, on what terms it sells goods and whether its credits are settled by note. One should also ascertain what are the firm's running expenses and what amount is withdrawn by its members for living expenses; what accommodation it receives at its bank, and whether it is out of debt once or twice a year. One of the principal points for investigation is the manner in which a concern buys its goods, and whether the buyer has a proper idea of what he buys, and buys in accordance with his requirements. Injudicious buying and the piling up of undesirable stock will seriously impair the resources of any concern and place it in a position where it will be difficult to dispose of its merchandise profitably. The old adage runs, "Goods well bought are half sold."

All statements should be analyzed with liquidation in view.

There are, generally speaking, two classes of people who fail; first, those who will not talk at all; second, those who will tell all that anybody wants to know and considerably more besides. A credit-man should beware of both under ordinary circumstances.

Many credit-men make bad extensions of credit because they do not pay enough attention to little things; in other words they do not appreciate the force of the saying that "straws indicate the way the wind blows." To illustrate: A friend of mine some time since cited an instance where he had refused credit because of information received by a member of his family from her dressmaker, to the effect that the applicant was not paying the dressmaker's bills promptly. He also told me of a livery-stable keeper who had given him valuable information which caused him to refuse credit to a man who had become dilatory in paying his livery bills and who, a little later on failed. Many credit-men hear and know things

about those to whom they are granting credit, that they do not at the time regard as significant; but when the concern fails they are reminded that they heard so and so a few years before. If they had followed up these leads, they would probably have escaped loss.

It is especially desirable also to investigate frequently. A great many losses are incurred because credit-men consider a man good for the reason that he has been good in the past. Each case ought to be carefully investigated each time it comes up, in order to ascertain if the person is holding his own, going ahead, or running behind.

The manner in which a firm pays its bills is an important subject of inquiry, for if a concern borrows money in the open market and also allows its bills to run until maturity, it plainly indicates that something is wrong, and that it is virtually burning the candle at both ends.

The sales, capital, and terms on which a house sells its goods should be carefully considered and compared. There is a proper relation between them, and a mathematical calculation will prove the truth or falsity of the statement. If we have data covering these points, together with a detailed statement, we can form a good judgment of the credit of a concern. These facts will also serve to bring to light any dead or doubtful assets, and they will frequently show whether a concern has the capital it claims. This information is of great importance, and it should be the aim of every credit-man to obtain it.

A man's personal habits should be closely inquired into, for if he is loose in these he can not be expected so to change his life that he will be straight in his business affairs. Punishment should be meted to those people who make false representations of their condition, and thus obtain credit when their financial affairs do not warrant its extension. Another thing of which I am firmly convinced is, that where a concern fails and pays only twenty-five cents on the dollar, if it should go into business again, it should not be accorded the same terms and privileges as a firm in the same town that has paid

one hundred cents on the dollar for its stock; in other words, the man who has compromised his credit should not be placed upon a plane of equality with the man who is strictly honest and has paid dollar for dollar. Too frequently the trade are anxious to commence selling to a man immediately after his failure, and compromise, which only serves to encourage dishonest practises.

Dishonesty and fraudulent failures are attracting too little notice, and the parties are too often allowed to escape unscathed; whereas, if they were held to a strict accountability for their crimes, it would clear the business atmosphere and the result would be of great value to the mercantile community. Its moral influence would be excellent, and it would plainly indicate to other dishonest debtors that they must expect the same fate. I sometimes feel that banks and mercantile creditors are in a measure responsible for allowing guilty parties to escape merited punishment. When a dishonest failure occurs, creditors are often too anxious to secure whatever dividends may be coming to them, and this encourages the swindler in the carrying out of his nefarious practises.

There is no good reason why parties who are guilty of making fraudulent failures should not be punished to the fullest extent, for there is little difference, if any, between a man who robs you of your purse and one who, by a successfully constructed network of falsehoods, has obtained money or its equivalent in merchandise from your institution or firm. Dishonesty and deceit are at the bottom of these failures, and men with propensities in that line are certainly better behind the bars, where they can be restrained from doing further evil.

I am thoroughly convinced there should also be erected a bar of public opinion beyond which these dishonest persons can not pass. They should be ostracized from the society of all honest and upright business men, and should be made to pay the full penalty for their acts.

In recognition of the importance of this phase of business, our large merchants have long since established credit departments in their business, and placed credit-

men in charge, whose duty it is to look up customers and secure statements from them. The burden of responsibility resting upon these employees is very great, and, generally speaking, they are among the best paid men in the office.

From the nature of his duties, the credit-man in any business is an important factor in determining its success or failure. It is not a question of how much goods can be sold, but what volume of business can be transacted with only minimum losses from bad debts, and how sales can be increased each year with a decrease in the percentage of loss. This is a subject that interests us all, for when the year closes and we make up our figures, we are naturally very anxious to exhibit a satisfactory record.

The credit-man's duties are arduous and exacting. He is not only called upon to perform considerable detail work, but his mind must be ever active and alert, in order not only to keep his files closely up to date, but also to be continually posted as to the present situation of his debtors.

A credit-man should be of an investigating turn of mind, and should have an agreeable yet indomitable obstinacy; and when he has determined not to trust a man, he should strictly adhere to his conclusion.

It is necessary that the credit-man should be a good investigator, and that he should ask the right questions. In illustration of this point, I heard of a case where a credit-man called upon the head of a firm for information regarding a certain party. His first question was, "Do you sell this man?" and the reply was, "Without limit." It occurred to the inquirer before leaving that it might be well to ask the terms upon which the goods were sold, and the response was, "Always for cash." If the credit man had not asked this last question, he would have gone away with an erroneous impression, and might have been led to allow a large bill.

A good credit-man should not, usually, be much of a talker. He should always have a pleasant manner with all classes of people, for the reason, if for no other, that

he can not tell when some one of the many whom he meets knows something which he should know.

The credit-man should be a good listener, and a good propounder of questions, and if he can get others to do the talking he can do the thinking.

Credit-men should keep themselves thoroughly posted in regard to the laws of the States in which they are interested, in regard to crops, industrial conditions, manufacturing, strikes, etc., the general character of large cities, which are most favorable locations for business, and the competition in such places. They should also have a general idea of the amount of capital necessary to conduct business under different circumstances. Very often there are several customers of a firm in a single town, and the credit-man should know the standing of each of these customers, which ones are the best to sell, and the probability of success of any new concern that may start in the same town.

Many credit-men endeavor to keep their information stored in the recesses of their minds. This I do not believe to be good policy. The facts as obtained should be carefully noted and put away in such convenient forms as to be readily accessible. No man can safely depend upon his memory alone, and the chances are that the credit-man who follows this system will sometimes be confused as to names, and the effort to keep his mind charged with this knowledge will prove a serious strain upon his physical and mental organism.

The credit-man should be thoroughly acquainted with business systems, customs and usages, and should endeavor to ascertain if the people to whom he gives credit are themselves carrying out correct principles in their own businesses.

It does not seem essential that a credit-man should have any expert knowledge of accounts; but he should have a general knowledge of the subject, in order that he may be able to judge, if he goes to a concern and looks over the books, whether they are properly or improperly kept.

One of the necessary qualifications of a credit-man

is conscientiousness. He should endeavor always to get at the unfavorable information regarding his customers, as facts of a favorable nature take care of themselves.

I think that one of the chief characteristics of a credit-man should be industry, as it requires hard work and continuous delving to secure information. He should be the possessor of a judicial mind, that he may impartially weigh the evidence placed before him.

The credit-man in a mercantile house should be a systematic and efficient collector. He should see that the accounts of his firm are kept alive and moving. He should not be too lenient or indulgent with slow-paying trade, for, if such a policy is pursued, the delinquents will be quick to take advantage of the situation, and as a consequence there will be much uncertainty as to whether recovery can be had on the firm's accounts.

The main qualification of the dispenser of credit is a trained and accurate memory—the judgment to separate and cull out the really important information and apply the remedy, whatever it may be.

Courage is one of the chief requisites of the credit-man. He should stand by his convictions and not hesitate to refuse to trust a firm, if after a thorough and painstaking investigation he feels they are not safe people with whom to do business. Sometimes pressure is brought to bear upon the credit representative of a mercantile house by salesmen who are anxious to secure commissions, but a credit-man should not alter his determination to approve only those risks of which he feels reasonably confident.

Some good credit-men always want to make up their minds before they see the applicant for credit, as they do not wish to be influenced by a pleasant personality as against facts. Others, however, prefer not to make a decision until they have seen the applicant, and claim to have sufficient weight and balance not to be influenced by a pleasing personality, which has nothing to do with a man's solvency or his ability to pay his debts.

The credit-men of to-day are often placed at a great disadvantage, because they frequently do not come in con-

tact with the parties to whom they extend credit. In other words, they are at arm's length from their customers, and they do not have the opportunity of talking as freely with them and forming as close a judgment of their personal character as was possible in former times, when the merchant himself came to the business center and bought his own goods. This makes cooperation between credit-men all the more necessary.

I can not refrain from urging upon credit-men generally the advisability of pursuing a policy of cordial cooperation with each other. Always be ready to answer inquiries, and do not regard them as something to be avoided. To an experienced credit-man these inquiries are of great value, and he will often desire to know from what source they emanate and for what reason they are made. I have talked with a great many credit-men regarding this matter, and they tell me they generally receive from the inquirer more information than they impart. "Scanty fare for one will oftentimes make a royal feast for two." Some people are so narrow-minded that they frequently stand in the way of their own advancement.

If you have a good thing, do not hesitate to let your neighbor have the benefit of it.

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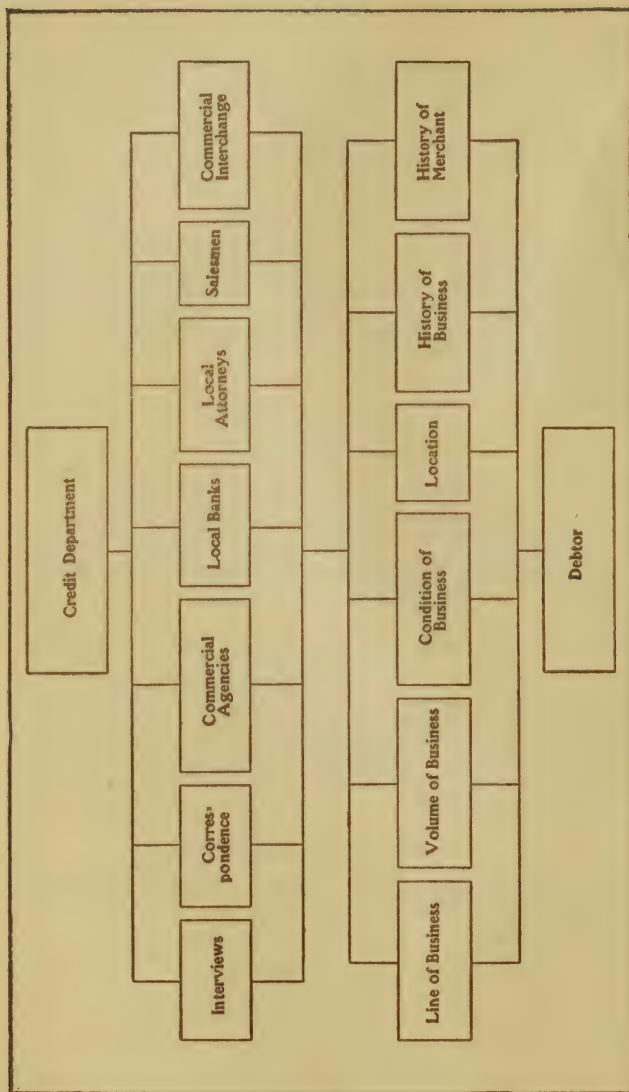
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CREDIT

I. THEORY OF CREDIT

THE word "credit" is used in business transactions in a dual sense. It is, first, an accounting term which applies to all items accruing to a certain head, or "credited" to it, as distinguished from "debited" or charged against it. Its broader meaning, and that with which we are at present concerned, alludes to that important channel of trade by which an individual or concern can procure goods on promise of future payment.

All goods, honestly obtained, are procured in one of four ways: (1) by free gift, or inheritance, (2) by cash payment, (3) by exchange of other goods or values, or (4) by credit.

In a popular sense, credit simply means the ability to purchase an article of merchandise on deferred payment. It is controlled by the seller's confidence in the honesty and resources of the purchaser. In the commercial sense, however, it is something more than confidence, and rests upon a more solid foundation. Here the granting of credit is based upon accurate information concerning the assets, prospects and ability of the buyer to meet his obligations. Being based thus upon ascertainable resources, it can be converted, upon demand, into equivalent values. This is the scientific theory of credit, but in actual practice it is more elastic. A safe, prospective credit can not be rigidly fixed to cope with every individual instance. The successful business man must always take this into consideration. If he does not, there are many lines in which he must fail. The cash system is not used

successfully to make many lines of business operations successful.

Significance of Credit in Relation to Trade.—The significance of credit in relation to trade may be summed up in a single sentence. Credit is the cause of most business losses, but it is also the cause of most great business successes. The problem of credit management, therefore, consists in the endeavor to reduce the former and to increase the latter. For the sake of the one, credit is discouraged; for the sake of the other, it is encouraged. The problem differs in every individual case; it differs also in every type of business—but certain principles are true of it all the time.

The subject is also interrelated in every possible way. For example, the retail merchant extends credit to his customers, but asks credit of the wholesaler. The latter, in turn, while extending such credit, requests credit from the manufacturer and jobber; while each and all of them obtain funds, or credit, from the banker. It will thus be seen that the factor of credit increases the volume of business tremendously over what it would be if all business were conducted on a strictly cash basis. The same dollar may be used over and over again until it serves the purpose of ten. The old story of five men who discharged all their debts with a single dollar will serve to illustrate the point. Peter owed Paul the dollar; Paul owed it to John; John owed it to Charles; Charles owed it to William; and William owed it to Peter. Peter thereupon paid his debt to Paul, and the latter discharged his obligation to John, and so on down the line, until William returned the sum to Peter. The latter had his original coin in pocket, but all five debts were squared.

Credit a Popular Policy.—In general, business houses find it advisable to be liberal in making credits, since this policy brings popularity, and popularity means success. The necessary corollary of this practise is a policy of sharp collecting, which also, if tactfully managed, may add to the esteem in which the house is held. This rule

holds good, whether the business is wholesale, dealing with other concerns, or retail, dealing with individuals. A man likes to feel that his credit is good, and that his name is sufficient warrant for obtaining goods. He also finds it a matter of convenience—perhaps of too great convenience, since it may tempt him to buy more freely than he otherwise would.

Determining Factors.—The factors determining the extension of credit are varied, and may change with each instance. As a whole, however, they may be summarized as follows:

1. Applicant's line of business.
2. Volume of business.
3. Condition of business.
4. Location.
5. History of business.
6. History of merchant.

1. The Applicant's Line of Business.—This factor is, perhaps, the most important, for by it the selling house can determine approximately the average terms on which the subject buys his goods; and knowing the class of goods he sells and the way he pays his bills, a credit man can readily demonstrate the comparative responsibility of the account. Take, for example, a man engaged in the house-furnishing business who is reported as "sixty days slow." What is his net responsibility as compared with his liabilities, in the event of adverse conditions? Generally speaking, furniture is now sold upon sixty days' time, with an extension frequently of as much more. Other house furnishings are handled upon much the same terms. Therefore, if the slow buyer delays sixty days more it means an interval of six months from the time the goods are delivered by the seller until payment for same is received. Counting interest on and use of the money, expense of collecting, etc., this means very little profit, if not a positive loss to the selling house.

Other lines of trade, such as millinery, clothing, holiday novelties, etc., are subject to the seasons. A much

larger volume of business is done at one season than at another, and for this reason credit should be correspondingly flexible.

2. Volume of Business.—The second question is, How much business is the retailer doing? If he is turning his stock over four times a year—and most retail concerns do this—it is evident that the goods purchased six months before were sold within three months, and in order to pay for them he has had to buy more goods and sell them. Consequently it is reasonable to believe that if he should fail, a compromise could not be expected offering more than 50 per cent.

3. Condition of Business.—A man may do a brisk business and yet fail. In fact, many a merchant has overreached himself by trying to do more than his rivals. He has undersold and thus cut away all the profit, or he has granted too much credit, or been slow with collections, or stocked up with poor or unsalable goods. All these and a variety of local conditions must be looked into. The financial statement of the house should also be very carefully analyzed with a view to ascertaining the quick assets as compared with the quick liabilities, and also as to whether or not the outside holdings are available. In making terms a credit man ought to know whether his customer has many accounts falling due at the same time. If such is the case, the customer will find it difficult to pay them all at once, and will probably ask for an extension.

4. Location.—The matter of location is exceedingly important in determining the length of time to be allowed for payment. A small country merchant depends largely upon the trade of the farmers and dairymen in his section. In the years when crops are good, his trade should be brisk and his collections good, since farmers generally pay in cash.

In a mining town, also, under ordinary conditions trade in small articles and necessities is good, and payment is

prompt. But should a labor war arise the effects would be disastrous.

A growing town of more than 5,000 inhabitants, not dependent upon any one class of producers, offers less chance for fluctuation of trade and credit than either of the above.

5. History of Business.—A business house which stands well in a community, due to a long period of square dealing, is entitled to more credit than its actual assets and liabilities may seem to warrant. The intangible but very vital asset of good-will is here present to be reckoned with. It is easily seen that if a house has been in one location and in the same business for twenty years, doing a fair volume of business, of good reputation and fairly satisfactory with its payments, it should be in a position to pay for a purchase covering reasonable requirements sometime near its maturity.

6. History of Merchant.—The former history of a merchant is a matter of considerable importance, and it is certainly undesirable to sell freely to the proprietor of a business who has failed several times in the past. Other matters to be considered are, whether or not a man is well regarded in his home circle, if his stock is well kept, if he gives proper attention to his business, and what is his custom in paying bills. The man who discounts his bills has usually three or four times as much in quick assets as he owes in quick liabilities. He who pays when due, but not before, has usually twice as much in assets, while an account habitually slow is one that should be avoided.

Limit of Credit.—A definite limit of credit should be assigned every customer, no matter what the reports and indications may seem to warrant. This may be \$5,000 or \$500,000, but after once establishing a credit limit, it should not be raised without again carefully reviewing and closely investigating all circumstances surrounding the case. On the other hand, should the customer fail to

meet his first bills promptly at maturity, the limit of credit should be reduced to one-half the previous amount. If he is unduly slow the second time, his limit of credit should again be cut in half, and before filling his third order, a letter should be written to the customer reciting the previous unpleasant experience, and asking him what may be expected in this case. If after receiving his reply, the order is filled and he is again slow, the limit should be erased entirely, and the salesman instructed to sell him only for cash, or avoid him until such time as conditions change. This does away with the unpleasantness of turning down an order.

Differences in Policy.—There are many differences in the application of credit to manufacturing, wholesale, and retail trade. The manufacturer deals with the entire country and even foreign countries, while the wholesaler generally deals only with a specific territory. The former welcomes distant accounts, the latter views them with caution. The manufacturer is generally advertising his goods and wants them to go everywhere. The wholesaler is merely anxious to dispose of his goods promptly, and he can do this better near at home than at a distance. The manufacturer's credit man is thus forced to take greater risks than the wholesaler.

But the differences in credit policy between manufacturer and wholesaler are not nearly so marked as between wholesaler and retailer. Here almost every phase of the subject is different—the classes of customers, the type of credit information, the methods of opening accounts. The aim of the retail credit man is to open as many accounts as possible, but in such a way that the percentage of losses will not increase. He is judged almost wholly by the volume of his sales, and he knows, that, considering the retail competition, he should do his utmost and even advise customers to open accounts.

Retail Charge Accounts.—The element of charge accounts in a retail business is, in fact, of high importance. Some of the greatest department stores of this country

owe their success to their skill in handling and creating this class of trade. They have learned that the charge account holds a customer, induces him to concentrate his buying, and really connects him with the house, while the cash customer buys everywhere and seldom becomes a regular customer anywhere. The charge customer is favored upon every hand. He can order goods quickly and easily, without "waiting for the change." He can return goods if dissatisfied. He can obtain goods when he needs them and pay for them later, at his convenience. This may result, as we have already said, in his buying more than he otherwise would, but the result is beneficial to the merchant, provided the account is good.

Differences in Service and Terms.—Other wide differences between manufacturer, wholesaler and retailer is in the matter of service and terms. The large general houses, in the question of service, are interested only in accuracy and prompt payments. Their demands may be couched in cold, business-like terms, and yet the recipient will not resent it; he is accustomed to such transactions and realizes that they are purely routine questions between the credit man and himself.

But the retailer, in dealing with his customers, must adopt a far different policy. Here the personal equation must always be recognized and allowed for. The customer is often a woman whose future trade depends upon how well she is pleased, and how tactfully her account is handled.

Not only does credit policy differ in different types of business, but the terms of credit are also different. In general lines of business, terms are so adjusted as to allow of the purchaser's realizing upon the goods bought before the bills for them fall due. The manufacturer will perhaps sell to the jobber on six months' time, while the jobber will in turn sell to the retailer on three months' time. This is because the jobber has to collect from the consumer indirectly through the retailer before he can pay the manufacturer, and therefore requires twice as much time as the retailer himself. Where the manufacturer

deals directly with the retailer the terms are correspondingly shorter.

The Use of Coupon Books.—Coupon books, the use of which began with railroads, street-cars and restaurants, are now being utilized more and more in general lines of business. While apparently issued as a convenience to the customer, they are really a great money-getter for the merchant. For example, one of the taxicab companies of New York City has recently begun issuing \$20 worth of tickets for \$19. While ostensibly giving the patron 5 per cent on his outlay, it actually figures out a substantial profit for the taxicab. The man with these books in his pocket will probably use the cab more than the other fellow; and last but not least, the company gets all the cash in hand in advance.

Many merchants now use the "coupon book" plan in connection with their credit system. This is, perhaps, a time-saving as well as a simple form of handling the credit business. The customer is given a book of coupons redeemable in merchandise and, in some cases, gives his note in settlement therefor.

How Handled in Bookkeeping.—The one advantage in this system is in eliminating the necessity for making an entry on books every time a customer buys on time. The entry will have been made, and the coupon received will be considered as cash. In making the entry, Bills Receivable account is debited for the note, but the question is, what account should be credited? Merchandise account should not receive this credit, for no merchandise has been advanced, and the actual gain of the business would not be correctly shown unless there were unredeemed coupons. To overcome this difficulty, therefore, it is desirable to open a Coupon Book account and credit it with the amount of the coupons. Debit Coupon Book account as coupons are redeemed, same as Cash Sales, either daily, weekly or monthly, as may be preferred, and credit Sales account or Merchandise. The books will then show accurate profits at the close of business, and if

there are any unredeemed coupons, the credit balance of Coupon Book account will represent the liability for unredeemed coupons held by the customers.

If a note is not given, of course, the customer is debited with the coupon book the same as he would be charged with anything else, and Coupon Book account would be credited, but none of the coupons should be accounted for in the Merchandise account or Sales account until they are redeemed.

2. CREDIT INFORMATION

The extension of credit is based directly upon the qualifications of the borrower, first as to character, second as to ability, and third as to property. The entire credit system is founded upon the interchange of this commercial courtesy, and the absence of it is more dangerous to business as a whole than any other factor. For practical purposes, of course, the natural basis of credit is in the net tangible assets, which may be taken as an approximate evidence of integrity, ability and property combined. A very important item to be considered is the relation between the volume of borrower's sales and the amount of his expenses, since the nearest index of a man's business condition is the degree of frequency with which his capital is turned over. The only means by which the creditor can obtain this basis for credit is through information of each individual case. Information is accordingly the basis of all credit judgment.

Methods of Obtaining Information.—The principal methods of obtaining credit information may be classified as follows:

1. Personal interviews and correspondence.
2. Commercial agencies.
3. Local attorneys and banks.
4. Salesmen.
5. Commercial interchange.

It is evident that methods of obtaining information

will differ, not only in individual cases, but also in the cases of different classes of trade, such as wholesale and manufacturing, retail and instalment. The credit department of a house must obtain every possible kind of information about trade conditions in general, about its own customers, and also about firms that may become customers, in order to be prepared in advance with a means of judging them. A credit customer must not be admitted until his standing has been determined by the credit man. The success of a business depends very greatly upon the completeness of its records, especially those which contain the business history of its customers, for what has happened in the past is liable to happen in the future, and a customer will on the whole maintain the business character of which he has given evidence.

1. Personal Interviews and Correspondence.—In certain types of business, especially in the instalment and retail trades, information has to be obtained almost entirely by direct personal means. Decisions often have to be made on the spot. A majority, also, of the customers in these kinds of trade are women who have to be treated in a more personal way than men, and who have not as definite a financial standing. Business men are rapidly growing away from their former hostility to frank statements of assets and liabilities. As progressive methods and business logic are becoming more universal, they are coming to see that a man who sells goods on credit has the right to know just what are his chances of receiving full return value; and also that refusal of this legitimate information would imply a concealment of facts about their financial condition which, if disclosed, would prevent them from receiving credit. They also know that these rules of business are hard and fast, and that the credit policy does not pertain to one house only, but to all.

The retail shopper, however, is not generally familiar with such matters, and may resent inquiry as to her "personal" affairs. Any correspondence on the subject, either direct or to some third party, must be tactful and

considerate. Make it appear simply as a part of the necessary routine used in each and all instances, and not at all as a personal doubt or hesitation.

With retail customers, where an interview is necessary, it should be as brief and impersonal as possible. A few casual questions or leading remarks may bring the information needed. The applicant's position or source of income, her present or past charge accounts, and the like can often be learned by a tactful and quick-witted credit man in a general conversation, during which inferences may be formed which can be corroborated afterward. The house itself gains by the reputation for not being unduly inquisitive. The credit man in the retail trade must depend almost wholly upon his power to size up human nature in the personal interview, and base his decision on the probable honesty of the purchaser.

2. Commercial Agencies.—Many credit men in the wholesale trade depend upon the commercial agencies for all their information about customers; and probably every house that sells on credit to other houses makes use of such agencies in some measure. Mercantile agencies came into existence as a result of the credit system, and in response to the necessity for specific and safe information about the commercial standing of all business organizations.

The modern mercantile agency may be called an official bureau of information with respect to the field it covers. It had its origin in the panic of 1837, and since that time has constantly grown in number, influence, and helpfulness, until now it holds a position of commanding influence. It had its origin in the exchange of credit information among the business men of New York City. Small "courtesy" fees were granted for this service, until as the idea grew rating books were published, and branch offices were established for the systematic collection of such information.

Their Prevalence.—General agencies may now be found with offices all over the United States. The largest

are the Dun, the Bradstreet, and the United States Mercantile Agency. These list all kinds of concerns, from the small retailer to the great corporation. The classification of business follows two lines: (1) That made upon the basis of wholesaling, retailing, and exporting; and (2) according to territory. A central office is usually found in New York City, with branch offices in the leading cities of the world. One agency maintains nearly two hundred offices in the United States alone. The extent to which a territory is covered is determined by its trade importance. The agency usually has an independent district office in each of the chief cities of the country, which in turn has under-offices in the smaller cities, while the latter oversee the territory directly about them. These offices are each equipped with a force of reporters, numbering in all many thousands, specialized in the important centers, each line of business being in the hands of a single reporter. The country dependent upon cities containing sub-offices is divided into reporting districts, and in small towns which have no office representative, a local attorney is engaged to make any necessary reports.

Methods of Working.—In connection with the regular force, special reporters are employed who cover the territory in order to gather specific information in regard to the credit of the different firms. These are specially trained men, and are often public accountants, expert in obtaining the truth from conflicting statements, and arriving at an exact knowledge of assets and liabilities. The work of the special reporter is supplementary to that of the resident reporter. Every court-house, or other place of public record, is visited by a special man who keeps the central office informed concerning failures and other business changes. Thus every enterprise in the country is watched, and all developments and tendencies in the mercantile world are brought into systematic communication.

The sources from which reporters secure their information are usually divided into different classes, according to the nature of the territory. Usually two classes

are treated: First the manufacturers, jobbers, and wholesalers; and, second, the retailers. The method of securing data for the first class is fairly uniform, while for the second class various methods are required.

After information is secured, the task of classifying it is scarcely less difficult. It must not only be accurate, it must be timely. Credit information especially must be carefully systematized and made available for immediate use. Delay can not be tolerated, because it may mean either the loss of an order or the granting of credit which may prove a long and doubtful risk. The card system of record has greatly facilitated the grouping of such information, in addition to making it more accessible.

Obtaining Information.—Reports are made regularly by the city reporters, and at fixed intervals by the country reporters. The purely news items, which form the basis of the daily sheets, are telegraphed at once from all sub-offices to the district office which issues the sheets. When a special report is asked for, the request is forwarded to the sub-office in whose district the firm asked about is situated. If there is no recent report on file, the investigation is then put into the hands of a reporter and the report is made up from fresh information and impressions gathered by him, supplementing whatever information has already been gathered in the sub-office. The reporters are called upon at all times to give information of a more general character than that required for the daily sheets; opinions and impressions of various firms and individuals, together with all facts that may indicate changes in their condition.

All this information is obtained very largely from the firms and individuals themselves. A direct statement is obtained as to capital, debts, open accounts, etc., and often the individual under investigation adds his own signature to his statement, which makes him liable in case of deceit. Business men have learned that it is worth while to be above board with the agency, since the latter has other channels of information—not only through personal and business channels, but also through

financial journals, court reports of suits and bankruptcies, trade papers, and the like. From all the mass of this information, the facts of which appear in the daily sheets, the quarterly rate book is revised.

Distributing Information.—The information of the agencies is given out in three forms: (1) Daily sheets containing mention of all new incorporations, bankruptcies, failures, and new business establishments; (2) a quarterly register or directory of the name, capital rating, and credit rating of every individual and firm in the United States and Canada occupied in mercantile, financial, or industrial calling; and (3) special confidential reports furnished upon request to subscribers, concerning any specific business house. Every precaution is taken against the use of these reports for purposes not legitimately mercantile. They are carefully detailed summaries of the character, history, ability of the individual in question; his wealth and debts, social standing and habits; and a general expert opinion as to the extent to which his credit is good and the proper manner of approaching him. The report is intended to put together significant facts, from which the experienced credit man can build up his own impression. The general directory contains the names of all the firms doing any important business in the United States, arranged by States and cities, with an assigned rating for each firm. One agency publishes the names and addresses, etc., of 1,300,000 firms and corporations. These are frequently changed by additions, obliterations, and other altered ratings, but every effort is made to keep them up to date. Naturally, this material is impartial, and it is now largely prepared with the active assistance of the houses which are being rated. Houses wish to establish an accurate rating upon going into business, especially where their dealings are in distant markets. In this way the commercial world is dependent upon the responsible agency.

Ratings.—The two ratings given in the quarterly rate book are the *capital* rating—an estimate of the amount

of the capital invested; and the *credit* rating—an estimate of the degree of confidence which can safely be granted to the given firm or individual. These ratings are the final judgment of the agency's experts, and that they are usually sound may be surmised from the confidence placed in them by the entire business world. The capital rating is the opinion of the commercial value or net value of assets which the firm may be supposed to have invested. The credit rating is determined more from the rater's judgment, after careful study of character, status, and history, of the degree of confidence which may be placed in the firm or individual, than from any percentage of the firm's honesty and means as evidenced in terms of money.

It must be borne in mind, however, that a considerable part of the information with respect to a concern's financial condition is secured from the concern itself, hence there have been many cases where a high rating has resulted from false statements. Many bankrupts have been able to secure higher ratings than solvent concerns because they have had no regard for the truth.

The ratings for the general agencies are less highly specialized than in the case of agencies covering special lines of business. For instance, the general agencies have about twenty signs for financial responsibilities, and nine symbols for credit standings. On the other hand, the special agencies employ about twenty signs for capital ratings, and as many as one hundred for credit ratings.

Special reports are kept in stock and these are revised every six months. These are largely the reports given out when such reports are asked for, because the information is generally revised immediately, perhaps within an hour. Special investigations are undertaken when there is no good recent report on file.

Cost.—The cost of the general agency service is \$100 per year. This sum includes the privilege of receiving two reference books published every six months for the United States and Canada, with the privilege of one hundred special reports. In addition to these, the sub-

scriber is entitled to bulletins and weekly reports. The special reports cover the entire history of a firm, and include confidential items such as letters from other firms doing business with the house in question.

Seyd's Reports.—England has an exceedingly elaborate and reliable system of commercial reports in the well-tabulated returns of the commercial agency of Seyd, commonly known as Seyd's Reports. In these reports every commercial house of any standing whatever is quoted in four different columns, giving trade extent, monetary credit and other information which serves as a guide to the exporter. These reports are the most reliable of any published in the country, our own not excepted. Seyd's Reports alone constitute a library, and, while they are expensive, to a large commercial house doing an important business with England they are an absolute necessity. The small merchant need not go to this expense for gaining the benefit of this elaborate system, as every banking institution of any importance doing a foreign business has this work in its library, and, true to the maxim of the banking world that it is the intermediary of commerce and trade, they allow their clients to consult it freely.

3. Local Attorneys and Banks.—In many instances, local attorneys and banks are used as reliable sources of credit information. The attorney is generally familiar with the inner life of his town and can give the newest information about individuals in it at first hand. But a certain amount must be discounted from his reports to allow for local bias. Local information should not be asked gratuitously. A certain customary fee is expected, and should be sent promptly, whether the attorney renders a bill or not.

The information supplied by local banks is almost always accurate and reliable. For obtaining credit information in foreign trade, banks are not only the most reliable but almost the only source. This of course does not apply to England, all mercantile information neces-

sary in regard to which can be found in Seyd's Reports. All important banking institutions have on file information about almost every business house of standing in the world, and where these records are incomplete they can obtain any information desired either by writing or cabling their foreign correspondent in the locality of the house under investigation. Moreover, the foreign banker is unwilling to give information about firms in his neighborhood, except to other bankers with whom he has relations. And as the foreign banker is by far the most reliable source of information, the bank is indispensable in foreign trade. It may be mentioned in this connection that there are throughout Europe private information bureaus of high standing. The only thing which tends to make them untrustworthy is the strictness of the European libel laws, which makes them hesitate to give information unfavorable to anybody.

Certified Statements as the Basis of Bank Credit.—

Bankers now frequently ask clients to submit statements of their financial condition. In the form adopted by the New York Bankers' Association, and recommended by it for use by its members, appears the question, "Verification. Have the books been audited by a Certified Public Accountant? If so, name and date of audit."

William A. Prendergast, Comptroller of the City of New York, said:

"This question of certification has only recently come to be regarded as a living issue in credit economy. The failure to have a concern's books examined at stated intervals has frequently permitted the growth of unwise practises. The fact of no examination of the books being made by an outside and thoroughly impartial person has left them absolutely under the control of those who may be either not entirely competent, or inclined to dishonesty. It is a matter of frequent occurrence that a firm will discover after many years that a trusted employee has been defrauding it through speculation. The latter condition would undoubtedly have been revealed if the books had been examined at regular intervals by

competent accountants. It is a healthy sign that banks have determined to ask and insist upon such examinations. This policy will have the effect of eradicating irregular methods and greater evils. Another beneficial effect will be the education of the business public as to the necessity for these examinations, which should be a matter of frequent and orderly procedure."

Credit information thus obtained is, of course, primarily for the use of the bank itself, in the granting of loans, but it is equally valuable as a channel of information to the outside world.

To illustrate the severe system of credit examinations in force among banks, the credit department of a New York bank recently prepared a summary of their investigation on 1,598 names of mercantile houses and concerns desiring credit. Of these 798 or practically 50 per cent were unsatisfactory. Many of these concerns would undoubtedly have secured credit in outside channels, but were rejected for minor reasons which appeared only after the most careful, painstaking and rigid investigation.

The following is a typical request blank issued by a bank for the use of its customers:

TO THE NATIONAL BANK IN THE CITY OF NEW YORK

Name (corporate style under charter).....

Business

Location Branches

For the purpose of procuring credit from time to time from you for our negotiable paper or otherwise, we furnish you with the following statement, which fully and truly sets forth our financial condition on the day of.....; which statement you can consider as continuing to be full and accurate unless notice of change is given you. We agree to notify you promptly of any change that materially reduces our pecuniary responsibility.

In consideration of the granting of such credit, we agree that if we at any time stop payment or become insolvent, or commit an act of Bankruptcy, or if any of the representations made below prove to be untrue, or if we fail to notify you of any material change as before agreed, then and in either such case all our obligations held by you shall immediately become due and payable without demand or notice, and the same may be charged against the balance of any deposit account kept by us with you, we hereby giving a continuing lien upon such balance of deposit account from time to time existing to secure all our obligations held by you.

The following Statement of Assets and Liabilities is a true transcript from our books, and may be verified by you at any time:

Assets			Liabilities		
Cash in Bank.			Bills payable for merchandise		
Cash on hand			Bills payable to own banks		
Bills receivable, good .			Bills payable for paper sold		
Accounts receivable, good			Open accounts		
Bills or accounts receivable, owing by officers			Bonded debt (when due)		
Merchandise, finished (how valued . . .) . .			Interest on bonded debt		
Merchandise, unfinished (how valued . . .) . .			Mortgages or liens on real estate		
Raw material (how valued . . .)			Chattel mortgages . . .		
Real estate			Deposits of moneys with us		
Machinery and fixtures			Other indebtedness and of what composed {		
Other assets and of what composed {					
.....					
.....					
.....					
Total			Total liabilities . . .		
			Capital		
			Surplus, including undivided profits . . .		
Total			Total		

Contingent liability { Accommodation indorsements
Indorsed bills receivable outstanding

Specify any of above assets or liabilities pledged as, or secured by, collateral, and state collateral.

Remarks:

None of our accounts are now assigned, and will not be assigned except on due notice to you.

4. Salesmen.—Salesmen, especially those who travel, are in a position to obtain information of the most reliable kind, if the credit man takes pains to educate them to the right kind of observation. If he is a whole-sale salesman he is apt to see the customer in his own home, off his guard, and in his true native colors. No-

body else has so good a chance of really "sizing him up." In order to gain the salesman's cooperation, however, the credit man will have to make him realize that while outwardly they may seem to be working in opposite directions, their prime motive is the same. The credit department is just as anxious to make the right kind of sales as the sales department itself. The salesman should be asked and expected, on each sale, to offer his opinion of the risk involved. Thus he will be made to feel more responsible, and will become more conscientious. He can soon be made to see that the fewer bad debts he brings upon the house, and the more he shares the work of the credit department, the more his opinion will count, and the less the credit department will interfere with his sales.

5. Commercial Interchange.—The fifth method of obtaining information necessary for the basis of credit promises to be perhaps the most fruitful of all, although as an organized system it is still in its infancy. This is the idea of a sort of clearing-house in which all items of indebtedness of every business man shall be gathered together, contributed by all creditors for their mutual protection. If, in regard to a given debtor, every creditor could have an accurate statement of all his other debts, the security of credit would be assisted more saliently than by any other factor; for by this means he would have a full, rounded view of his customer's financial character. To obtain trade information by direct communication with other creditors would, in the first place, be so complicated and unwieldy a method as to be impracticable. Moreover, there would be no scientific means of knowing that the information was complete, and that all the creditors had been communicated with. But a clearing-house, to which every reputable firm openly communicated its ledger accounts, would enable any one firm to obtain the complete debit records of any other firm automatically.

For the sake of establishing good references, or for other private reasons, a customer may elect to pay one

house regularly and promptly, while neglecting all other debts. The favored house thus gets an entirely false idea of its customer, and very likely ceases to watch his account with care. In this way houses often get caught. But if the real facts are known such doubtful practises are made impossible. Such a system will in many cases save the debtor himself, either from indiscreet overbuying beyond his resources, or when he has fallen into a critical position as a result of local conditions. All his creditors, working together from full data, can then agree not to close upon him, but instead may help him out of his embarrassment. The growth of this idea is an indication of the growing conviction among business men that absolute openness of methods is best in the long run, and in no matter more certainly than in regard to the records of creditors with debtors.

3. THE CREDIT DEPARTMENT

The credit department may be called the hub of the business, inasmuch as around it circulate many of the activities of the office—selling, accounting, correspondence, and every other function connected with the distribution of goods. It is at once an outlet for the extension of business and a check upon doubtful accounts. If well managed it may foster trade, and if badly conducted it may seriously hamper the efficiency of the sales department.

The policy and organization of this important department depend wholly upon the credit man, who is its manager. His office staff and plan of organization have already been outlined in the chapter of "*Office System and Management*" (p. 233). But the actual working of this department will bear further consideration.

The Credit Man.—The credit man's position is one of such great importance and responsibility that he is often a member of the firm, and generally the head of all the office work of the house. He controls the collections and oversees the accounting department, in addition to

his immediate work as chief of his own department. He may even act as cashier as well, with supreme control over the bank accounts and all the money affairs of the house. He has been called the "student of the business concern," the real thinker, the philosopher. His province is to reach conclusions about men through personal relations with them, and by the study of records and reports. His success may be measured by the average annual losses; the average percentage of discounts based on receipts; the accounts receivable gaged by the average number of days' sales represented by them; and, if he has charge of the office, the general office expenses. His duties are more complex than any other individual in active management, because they embrace a part of every side of the business. His office is to sell as much as can be sold with the smallest possible percentage of losses, with the smallest percentage of orders declined, and at the smallest expense. He can keep the losses down by being timid in making credits, but in this event he errs on the side of caution. He must be bold as well as cautious, and must take the same care to increase sales as to make them secure; to attract prospective customers as to retain present ones. And where he thinks it unsafe to grant credit he must yet try to retain the customer's good-will and trade by the use of other methods.

Qualifications.—"The qualities which make a good credit man can not be put into exact terms," says Dr. S. E. Sparling of the University of Wisconsin. "The work that he performs is the most delicate in the whole range of business. It is delicate because it touches a man at his most sensitive point; it concerns his property, character, and financial ability. It is one thing to have a good record as a credit man for refusing orders, and another to have a low percentage of loss upon large sales. For this reason a comparison of sales and expenses is a good indication of the good management of the credit department. The credit man is the guardian of the treasury and assets of the firm. He can create

financial ruin, or he can develop financial strength, or he can destroy business by assuming a dangerous risk.

"Naturally, the most successful credit man is one who has the fewest losses, and holds trade. A shrinkage in business does not necessarily reflect upon the credit man. But it is obvious that the manner in which credits are handled greatly affect the total value of business. For instance, severity and extreme conservatism will drive away business, while freedom of granting credit may bring loss. The credit man can quickly ruin a business. As a financial authority his judgment is final. He knows every customer of the house by name, reputation, and financial standing.

"It is a grave matter to deny credit, because it means the loss of trade, so that the credit man must move slowly. A successful credit man is one who will approve the largest number of orders, and keep his loss to a low percentage. In addition to his knowledge as a business man, he should also have a working knowledge of commercial law and bookkeeping."

The weak credit man is destructive; the strong credit man is constructive. He will be really interested in the affairs of his debtors, largely because he will take the trouble and have the intuition to know them well. He will be an active adviser in their affairs and be quite frank in keeping down their accounts to a figure that will be mutually advantageous.

His prime qualifications is a wide and conservative understanding of the methods and conditions of business. In judging of any proposed credit, he must know more than the immediate resources and character of the applicant; he must, in the wholesale business, be familiar with business conditions in the applicant's territory, so as to judge in a really broad way of his ultimate value as a customer. And, in the case of a retailer, he must have minute specific knowledge of the local business conditions. Failures and strikes in the neighborhood will affect the situation of many of his customers, and he must have such facts in his head when he is judging credits. He must have some knowledge of business law,

for he will have occasion more than once to act as receiver and trustee for a delinquent firm. Above all, he must have tact, the faculty of quick and sure decision, memory, which is a part of tact, to be able to place each customer at once and know all about him. This implies sympathy and a natural and often expressed friendliness which will place him en rapport with his customers and enable him to get the best part of his necessary information from them. This sympathy and genuine interest in his customers will serve his judgment in good stead in many difficult cases. There are times when the best customers will have to ask for an extension of credit, times when the stupid credit man would foreclose and go to law, perhaps recovering only a small percentage or nothing as the result of a forced bankruptcy; but at such times the good credit man has a chance, by being easy, of cementing a firmer and more valuable friendship and of ultimately recovering the whole obligation, to say nothing of doing a generous deed.

Dual Nature of His Duties.—The good credit man will understand that his work is both to prevent and to remedy; to prevent accounts from being entered which will be difficult or impossible to collect; and to remedy, by collecting, or doing everything possible to collect, accounts that have been entered. No two customers can be treated alike. And this fact makes it advisable for the credit man to have imagination. Endless originality in methods for every case and continual freshness in methods will naturally follow in a man who has trained himself to understand human nature, for the individual character of each customer will automatically suggest an individual way of treating him.

The credit man must have a keen, decisive mind, with a faculty of analyzing masses of information and sifting out what is essential, and he must have the same faculty of coming to quick decisions about men; his impressions of character must be accurate. He must be sensitive to everything in the office as well, eager for advice, and on the most confidential footing with the salesmen, some-

thing which requires a remarkable kind of tact for a credit man.

He will be cautious, but he will know when to be cautious, and will know that the proper time is at the beginning, when credit can be refused without breaking a business connection. The second time for caution is after a customer has steadily paid his bills and has gained so good a reputation with the credit man that this vigilance has been somewhat cooled. Here he should guard against letting any account take care of itself.

Along with this necessary caution he must have its counterpart, boldness; for the volume of sales is just as much a result of taking risks as the losses themselves.

A Mind Free from Details.—The very responsibility of the credit man's position makes it necessary for him to avoid all routine work for himself. A great deal depends upon his original and fresh thought; his ideas; and in order to have the time and the freedom of mind necessary for this, he must delegate all other work that he can to his subordinates. For this reason, he must be on the lookout for newer and quicker methods, and must adapt himself freely to all changes.

In order to keep his mind free from details he should also be so thoroughly familiar with the business of his own house as to know the value of goods and to be able to estimate the amount of an order offhand.

For this latter reason and for many others, the best credit man is apt to be one who has grown up with the house. For he must know the history of all its customers from the beginning of their relations with it; and he must know the policy and the aims of his own house, as one can only know them from the contact of a lifetime.

Method of Procedure.—Let us say that the credit man in a retail house has decided to extend credit in a given case. What is the manner of procedure? The credit man places a definite monthly limit on this credit in dollars and cents, determined with reference to the customer's balance-sheet, and, although the latter is not

informed of it, he is not permitted to exceed it except at the credit man's discretion and careful investigation. This limit, with certain other important facts about the customer, is then registered in the files of all the delivery clerks throughout the store. When a charge sales ticket has been made out it goes to them to be O. K.'d for delivery. The clerks revise the lists every day in order to keep track of the number of purchases made, and thus estimate how much is still left for possible credit. If the limit should be exceeded, the card is passed upward through the routine path to the credit man. At the close of the day, the charge tickets go to the bookkeeping department, where they are recorded and filed, and sales slips are then passed on to the billing department where the items are made into bills. At the end of the month the bills are made up from the ledger account. In this case, the credit man acts as court of highest appeal.

In a wholesale house every individual order should be O. K.'d by the credit department, and if the information recorded thereon seems insufficient, the order should be held over until a specified day, by which time proper information will have been forthcoming. The accounting department is not authorized to stop credit after the limit has been reached. It must go on entering and billing orders until notified to stop. But when the credit limit has been reached, it should immediately notify the credit man, leaving the responsibility of decision with him.

In a retail house the credit man has a much less tangible hold upon his customers than in a wholesale house; for a merchant who buys from the wholesaler has definite assets, and purchases upon terms agreed upon beforehand. If he does not pay, he confesses insolvency—and that is the end of his business reputation. But in a retail business the customers are not responsible in this sense, their methods of doing business follow no set rule, and the credit man must exercise all the more vigilance to make up for such conditions.

Relation of the Credit to the Sales Department.—
A popular superstition in business circles is that a mutual

hostility exists between the credit and the sales departments. We have already pointed out that this is due to mistaken ideas in both departments. The sales department is too apt to take as its motto: "Sales only at a minimum of losses." For this very reason the two departments ought to be at special pains to work in harmony with each other, realizing that they both serve the common end of getting as much profitable business in the year as possible for the house. Moreover, the salesman can be of the greatest help to the credit man in gaining credit information—as we have seen—and any break or serious enmity between them is most dangerous. In order to have proper cooperation they should consult together as often as possible.

Relation to the Accounting Department.—The importance of close relations between the credit and accounting departments lies in the fact that it is absolutely essential for the credit man at all times to keep in the closest touch with active accounts. This is the actual history of the business written out for his guidance from day to day. For this reason the credit man is often the head of the accounting department, as well as of the general work of the office. The accounting methods should accord with his method of handling customers. At certain periods of the year, in most houses semi-annually, the credit man will overhaul all the accounts and reports on customers, and thus refresh his memory and give himself a fresh outlook over the situation. But by constantly studying the ledgers as well as the customers themselves, he can keep track of the amounts due, of the size of orders, and of the various degrees of promptness in paying. He must, therefore, have constant and immediate access to the accounting records and they must be kept in a manner both suitable and intelligible to him.

Recording Information.—In order to form a correct judgment as to the financial standing of a debtor, it is necessary to secure data from different sources, so that comparisons may be made before a final judgment is

reached. One course sometimes employed is to require a financial statement from the customer. By tabulating all such material, a fair idea of the financial standing of the merchant can be obtained.

It will be found useful to have all this information filed in two forms; systematically filed in extenso in separate folders for each customer, and also in a handy summarized form, for quick reference. The large folder should contain everything gathered about a customer from agencies, banks, lawyers, salesmen, personal statements, and newspaper clippings, classified according to some system, all the items about each phase of the man being, if possible, clipped together.

For the summary file, a series of cards is perhaps the most convenient form—a card to each customer. This will contain brief, exact information; the customer's name and address, nature and size of business, amount of capital, stock, bankers, business history, and such personal items as his age and general character.

The Credit Clearing-House.—In recent years there has been organized among credit men in similar lines of business what is known as the credit clearing-house. This has arisen for the purpose of giving credit men the same kind of service as that rendered by clearing-houses in other lines of business, notably in banks. It is a common meeting place where credit men may compare notes on the credit standing of their common customers. Its success is entirely dependent upon a full and mutual cooperation of those belonging to the association. In fact, it is an exchange of credit, trade, and ledger experiences, which forms a medium between the debtor and creditor, leading to a greater knowledge of local conditions, and broader experience in dealing with them. It is based upon the old adage that "two heads are better than one."

The information thus brought together is classified for mutual service. Among other advantages it prevents fraudulent overbuying, and has great possibilities in creating and maintaining normal conditions. It en-

courages the extension of credits, for the reason that the merchant in question will not care to go on the interchange files for arrears in payment of bills, after he knows that such files are in existence.

The credit clearing-house, however, has its limitations, and is best adapted to special lines of business. For example, a form of the credit clearing-house is found frequently among retail merchants. It is a common practise for local merchants to cooperate in ascertaining the financial standing of their customers. In this way they compare accounts, and issue "black-lists." This system has met with considerable success in the local field, and has done much to remedy existing abuses in this branch of business.

Credit Associations.—The idea of the local clearing-house has also expanded into State and national associations of credit men, which have developed into very efficient instruments for promoting better conditions. These associations have stated meetings, usually once a year, which are looked forward to enthusiastically by the members, as it means a broadening of business acquaintances and a freshening of business ideas in addition to being the safeguard for which it was originally planned. In these annual conferences the credit men compare experiences, working together for mutual assistance. Their prime object is to get rid of the dishonest and incompetent buyers by a discussion of credit methods and systems, and other matters pertaining to buying and selling. In this way a more enlightened view-point and a more economical system are secured.

The credit man is coming to realize to the full the value of this cooperation. He is constantly obtaining a more accurate knowledge of the history and methods of his debtors. The national association of credit men now has an enrollment of over 5,000 members, representing every important trade center in the United States. It has been of great service in bettering credit conditions, and in developing a proper credit department organization, all along the line.

4. CREDIT INSURANCE

Credit insurance is similar in principle and application to other lines, such as fire or accident insurance. It simply means that upon payment of a fee, or premium, the insuring company guarantees to make good the insuring merchant's loss from bad debts. It will thus be seen to furnish a parallel to the older lines of insurance, since the extension of credit involves the chance of loss. In fact the custom for the business man to cover his risks against fire by insurance suggested the extension of this principle to cover bad debts. Every account has its margin of risk, and this risk becomes insurable. The credit insurance company simply endorses the line of credit.

Still in Experimental Stage.—Credit insurance has now existed in the United States for about twenty years with fluctuating fortunes, and has not yet attained a wide success or general recognition. It is based on the theory that in every business there is a certain percentage of loss from bad debts, and that although the loss in excess of this normal average can not be reckoned in any special case, a working average can be obtained by comparison of the accounts of many business houses.

Each house has its normal average of bad debts which has formerly been taken for granted and included with the cost of production. But where business is done on credit, extraordinary or unexpected excess losses may occur at any time. This may be insured against, by the law of averages, exactly as it operates in fire and life insurance.

The rates are based upon their average loss and can be figured out with as much certainty as in the case of loss by fire or by death. Commercial mortality is determined by known data, and is classified according to the different lines of risks.

Working Methods.—The credit insurance company investigates each risk individually as soon as its services are

applied for. From the commercial agencies it obtains complete and specific information about the applicant. This investigation is continued in the house itself. Its books are overhauled. What is its general policy in credits, its class of customers, the size of its business? How promptly does it make collections? It is asked to show the records of its losses for several years, with a statement of average loss, perhaps for five years. Taking into consideration all the facts gathered in these two ways, the credit insurance company then determines three points: (1) What sum represents the normal loss of the house, over and above which losses may be indemnified; (2) what is the annual premium; (3) what is the per cent and what shall be fixed as the limit of indemnification.

Advantages and Defects.—The advantages and defects of credit insurance are very complex, and the business world is not by any means agreed as to which of the two overweighs the other. It is intended to place the sentiment of confidence which lies at the bottom of the credit system upon a secure financial basis, and by giving confidence a guarantee prevent panics and encourage boldness and initiative in all operations of trade. For one thing, it enables the business man to count his costs to the penny in advance, for he has merely to include his normal loss and premium in his production expenses, knowing that he can lose no unreckoned sum through bad debts; this gives him more assurance about his affairs. Moreover the credit man can take risks more easily and spread out more confidently. But at the same time he is not less careful in watching his accounts, because he knows that his losses are indemnified only up to a certain amount; and he will be sharp in collecting because, if many of his accounts lag behind, when the insurance company comes to make up a new estimate they will be counted among the year's losses and the average will be raised. Besides, now that the normal loss has been regularly counted in the expenses, if he can reduce this average it will be a pure surplus very much to his credit.

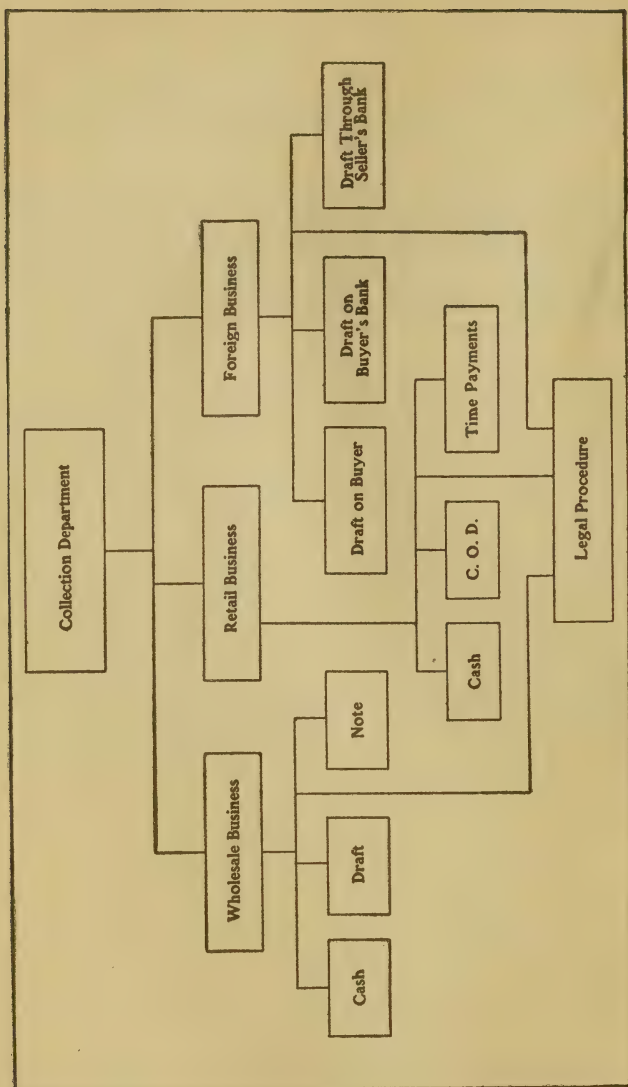
On the other hand, the security offered to the credit man does tend to make him substitute the terms of the policy for his own judgment. It encourages him to take risks he would not otherwise take, and which only a very exceptional credit man would be justified in taking.

Bonding and Trust Companies.—In the final analysis, the stability and value of credit insurance goes back to the stability of the insurance company itself. The most general form of credit insurance is that undertaken by the large bonding and trust companies. These cover various risks of contract, or enterprises involving risk. Whenever an individual or company engages to do a certain work, the law of business practise requires a guarantee of good service, or a faithful discharge of duties. This may not assume the exact form of credit insurance, but very often it takes the form of a financial guarantee involving return of money, in the event of non-fulfilment of a contract. Some of these transactions, however, are mercantile in character, and consequently involve the principle of credit insurance. The bonding of employees in positions of trust is becoming a general practise, such a bond being preferable to both employer and employee; the former, because it is issued by a company engaged in that business and with presumably ample means to make good any loss; the latter, because he is spared the necessity of asking relatives or friends to sign such an instrument in his behalf.

XXI

COLLECTIONS

Duties of the Collection Department—The Collector—General Rules for Collection—Some Reasons for Prompt Collecting—Methods of Collection—(a) In Wholesale Trade—(b) In Retail Trade—(c) In Foreign Trade—(d) In Instalment Trade—Voluntary Payments—Forced Payments—Usual Procedure—Foreclosure—Banks as Collectors—Collection Letters.



METHODS OF COLLECTION

XXI

COLLECTIONS

THE amount of capital needed to run a business bears a close relation to the amount of outstanding accounts, and this in turn is dependent upon the efficiency with which collections are made. Prompt collecting serves to keep down outstanding accounts, and at the same time has a salutary effect upon the attitude of customers toward the house. Most customers respect a house which shows that its accounts are closely watched, and will pay its bills earlier than those of the house which is slovenly in collecting. Then, too, if a bill is not collected, a customer will often transfer his patronage to another store partly because he does not wish to increase an already large amount, and partly because he fears he may be refused further credit; while a customer who pays promptly will come back all the sooner to purchase again. A customer can be educated to be a prompt payer by a series of tactful reminders and a clever collecting system in general. The object of a collection department, in fact, is rather to train customers to pay bills when they mature than to collect money after it is due. Prompt collecting, moreover, reduces the percentage of losses, for the older a bill grows the smaller grows the likelihood of collecting it. The basis of every collection system should be that a day's delay in payment must not be allowed, without the reason being known.

The collection department is closely connected with the work of the credit department. They are so intimately related that it is impossible to separate them in some lines of business. The aim of the credit department is to keep the accounts upon a collectible basis, and the more thor-

oughly this is done, the easier the work of the collection department. In fact, the two services are so closely allied that they are frequently handled by the same organization.

Duties of the Collection Department.—The duties of the collection department are threefold. It must (1) provide means by which the credit man may approve an account; (2) afford security for goods sold; and (3) maintain an economical and efficient method of obtaining money from outstanding accounts. It must keep the collection manager automatically in touch with debtors, informing him of the general state of accounts and when they become overdue. It should keep a concise, thorough record of all customers so that their entire business history from the beginning of their dealings with the house can be always ready for the credit man to consult.

The Collector.—In the opinion of many specialists a good collector is more important to a business than the ablest credit man. It is he who carries through all the personal side and upon him falls the responsibility of training customers in such a way as to get them unconsciously into the habit of paying promptly. The good collector will make the customer think that he is paying at his own convenience and pleasure, but such payment will nevertheless be arranged to coincide with the creditor's pleasure.

When the collector sets out to glean his harvest of accounts, it is then that the possession of the necessary qualities of tact and finesse in handling customers will have a decided bearing on the upward tendency of the sales record of his house. Similarly, the absence of those qualities will have a correspondingly depressing influence. The cultivation of politeness is something to be carefully studied; there are many reasons why a man is unable to meet his bills, and among them may be some which are perfectly honest and natural. So it will be seen that to put a debtor into a state of antagonism is to lose his friendship and future custom, as well as probably to arouse a feeling of enmity, and no business house, how-

ever successful, can afford to have enemies; civility is never misspent. There is nothing which will awaken resentment so easily in the business man as an attitude of brusqueness or harshness on the part of the collector. It is ten times easier to lose a customer than it is to gain one, and the collector is not supposed to alienate custom which the salesman has built up. It is also easier to lead a debtor than to drive him to the paying point; and it is plain that to write an angry letter to the debtor or to get into altercation with him is not the leading method. It must not be forgotten, however, that the debtor must finally allow himself to be led and that there must be persistent effort beneath the courtesy. If the collector can, in the midst of his cares, preserve his sympathy for the unfortunate, then the unfortunate may find him willing to listen to excuses which are perfectly valid, and which are deserving of leniency. His knowledge of human nature will put him on his guard against the glib impostor and his excuses.

The collector often has much of the auctioneer's instinct in summing up at a glance the value of the stock and property of the debtor, so that in the event of enforced sale his estimate of their convertible value may not be wrong. At the same time an aptitude for summing up the business capacity of the debtor may assist him in determining whether it is safe to allow him time for repayment, or whether there are symptoms which demand speedy action.

The law does not excuse ignorance, and a collector who commits blunders in the proper procedure for recovery, or who grants exemption to the debtor beyond those allowed by the law, has only his own lack of knowledge to blame for mistakes.

General Rules of Collection.—It is a general fact that no two customers can be treated alike by the collection department of a house, and that no system of dealing with the debtor can be laid down to meet every case. Competition is too strong to permit the creditor to class all of his customers on the same level. One must be

threatened, another flattered, and so on. Each one has some vulnerable spot in his armor of unwillingness to pay. There are certain rules, however, which are worth adopting.

A bill should be sent out with each shipment. Statements should be sent on the first of each month, showing the standing of the account and whether any of the bills are due or not. The recipient will learn to understand that he is expected to pay at the proper time. If bills are not paid before maturity, statements should be rendered to the customers on the day the bills mature, notifying them, and requesting a remittance or arrangement for payment, failing which, draft will be made upon them with a given time.

If your terms are thirty days net, drive home the fact to your customer that you do not mean anything over thirty, but plain thirty.

Collect promptly. If you are lax about collecting, the debtor will fancy that he can be lax in paying. Besides, there may be others waiting payment, whose claims may leave you "out in the cold."

Some Reasons for Prompt Collecting.—There are at least three good reasons for rounding up all accounts promptly, which should never be lost sight of by the credit department.

1. Few outstanding accounts, and therefore less capital required to run the business.

2. Less risk of loss, by allowing accounts to run on and therefore permitting the debtor to incur further debts. If payment is demanded promptly the money will go to the proper party.

3. Influence upon volume of sales. The debtor who owes a heavy bill to a firm is not likely to place his current orders with that house. Prompt collection prevents the running up of too large an account and therefore unwillingness to add to it. So, too, a house whose collections are steady and assured can afford to give more liberal terms and will thereby secure a larger volume of business.

Methods of Collection.—Methods of collection differ greatly in different types of business, as for example in wholesale, retail, foreign, and instalment trades. But in all cases the course to be followed depends upon three considerations: (1) The value of the account; (2) the creditor's experience with customers; (3) the financial condition of the customer.

The collector must steer carefully between oversuspicion and over easiness. "Is the account in danger?" is the question he should put to himself. Most of the large firms have a collection manager, who works in connection with the legal and credit departments. It is obvious that consultation with the credit manager will indicate the standing of the customer, and where it is necessary to push claims, the legal department must be called in for advice and assistance. However, as in the case of credits, agencies have arisen which are devoted to making collections. These agencies are both special and general. The former is one covering a particular line of collections, while the latter covers most of the trades.

The best known illustrations of the general agency are the houses of Bradstreet and Dun, which have added to their credit work a collection business. One type of the special agency is the local company which takes accounts of local merchants for collection. In most instances collections are made upon a percentage basis. It frequently happens that the local retail associations do a collection business.

(a) In Wholesale Trade.—A bill should be sent out with each shipment of goods, followed by a statement rendered on the day the bill matures, to the effect that unless settlement is made a sight draft will be served by a certain definite date. To avoid giving offense, a sight draft should be accompanied with the clause "Unless other form of payment is desired." This gives the debtor an opportunity to send a check, ask for extension, or make any other kind of settlement convenient to him. If the debtor does not reply, the creditor should not fail to serve the sight draft on the day mentioned. If the sight

draft is not honored it should be presented a second time. If again dishonored, an explanation should be asked for. After this, the course of proceeding is entirely a matter of choice, and depends upon the character of the collector and of the debtor.

The sight draft, which used to be taken as a confession of insolvency, if dishonored, is no longer taken very seriously. Effective substitutions for it are the collection agency draft and credit bearing draft. If the merchant debtor dishonors the latter, he knows that this fact will at once become known to all the members of the credit clearing association, and that his credit will very seriously suffer by it. To remind a debtor that his credit is being imperiled is always very effective.

A method formerly employed very frequently by wholesale houses and manufacturing firms was to authorize their salesmen to make collections. In some instances the salesmen were held responsible for their sales, and were required to remit the full amount of sales, upon which they received back a certain percentage. The failure to do so was held as a loss charge against the salesman. But this was found to be unjust to all parties concerned. The functions of selling and collecting are entirely distinct, and call for special talents in each direction. A man may be a good salesman and yet a poor collector. A salesman is an optimist, but the collector must have sterner qualities. Again, collections not only take his time but actually interfere with the success of the salesman. There is always a competition for the trade of the slow-paying customer, as well as the other kind. The customer naturally lodges his complaint against the collection department, and if the salesman makes collections it tends to drive the customer to another house.

(b) In Retail Trade.—In turning from wholesale to retail collecting we find a great change in methods. To begin with, the wholesaler is dealing with other merchants who also employ the collector, who expect to be reminded, and regard the whole thing in the light of business. The retailer deals with individuals who resent

dunning. But the retail customer, even more than the wholesale customer, must be trained to prompt paying habits. This is because a retail house sells on a close margin; because, also, it is impossible to get as accurate information about and as firm a hold over an individual retail purchaser as a wholesale house can have over a retail house.

Furthermore, the retail house deals chiefly with women, and collectors have accordingly to be more adroit and less coldly business-like. Each individual case requires its special treatment.

(c) In Foreign Trade.—Collection in foreign trade must be handled, in each individual case, with regard to the customs, commercial standards, and banking facilities of the special country traded with. Three methods of collection may be mentioned: The simplest and commonest method is a draft on the buyer with shipping documents attached. In this case the seller sells the draft to his own local bank after attaching to it the bills of lading, insurance and inspection certificates, etc., of the goods bought and shipped. The banker then forwards the draft for collection to his foreign correspondent in the buyer's neighborhood, and the buyer can not obtain the goods until he has honored the draft.

A second method is used frequently when the consignee is not personally known to the shipper, when the shipper is unwilling to risk the expense of having the goods returned to him in case the draft is not honored, and especially in shipping to countries where credit and banking facilities are poor. This is a draft upon the buyer's bank. In this case the buyer makes a deposit in some foreign bank in his own locality. This bank writes to the seller or the seller's bank to the effect that the seller can draw on the buyer at this bank for a specified period and up to a specified amount, by presenting with his draft proper documents showing that the goods have been shipped. The seller then collects from the foreign bank through his own bank. This is the method generally used in trading with South American firms, and

those of other countries in which credit is at low rate and banking facilities poor.

A third method is used only with houses whose credit is certain and with accredited foreign agents. This is a "clean" draft, which is the same as making a sight draft on a domestic debtor. In this case goods are shipped without attachments directly to the buyer, and when the bill falls due, the seller draws through his own bank, which collects from its foreign correspondent in the buyer's locality.

(d) **Instalment Trade.**—The house which does business on the instalment plan has some degree of advantage in financial security, as compared with the retailer. One of the usual requirements is that a certain sum be paid down; the balance in instalments. But the seller secures himself by a contract, signed by the purchaser, which gives him a substantial protection against the loss of the goods, except when both goods and buyer mysteriously vanish. There is this weakness in the system, that the instalment house can not say to whom it will or will not grant credit. It is best to take all on trust and make no discrimination. It is very rarely that any one enters into an instalment arrangement with dishonest intent, and most instances of failure to meet payment are due to some unforeseen circumstance, or to overestimation of financial resources.

The collection department is necessarily prompt in collecting instalments due, for often the final instalment of a payment is merely a prelude to another order. Accordingly a system should be so arranged that every account is carefully watched, and collection made at the stated day, with prompt action in case of failure to pay, for one instalment missed is liable to make the account bad.

Voluntary Payments.—We should not overlook the fact that the collection department is essentially organized to look after the slow pay accounts and bad debts. The great bulk of outstanding accounts and credits is essen-

tially self-collectible. In other words, the debtor stands ready to pay on reasonable time. Credit is usually extended to good customers for a definite period, usually from thirty to sixty days. Often an open account is carried, with the understanding that remittances will be made at stated intervals. These voluntary payments are in a sense automatic, and the machinery for collection is only nominally called into operation.

An excellent method of securing prompt payments is through the system of discounts. By offering a discount, if payment is made within a stated time, many accounts are settled without resort to harsher methods. Sending out letters at stated intervals will also direct the attention of the creditor to slow payments, and accounts are either gradually settled or curtailed. It is frequently agreed upon between the creditor and the customer that at specified intervals the firm is free to draw upon the debtor. This does not refer to those drafts sent to banks for collection, but rather to those which are sent according to understanding.

Forced Payments.—In addition to voluntary payments, several more arbitrary methods are employed to bring about forced payments. One of the most usual is through collection of C. O. D. shipments. In one sense this can not be considered as a collection of an outstanding credit, but the method is successfully used to prevent a bad credit, and is a safeguard frequently employed in certain lines of business. Where the firm does not care to extend credit it is effective and satisfactory, at least so far as the sending house is concerned.

Another type of forced collections is through a draft sent to a bank or agency for collection. This calls into operation the organized machinery designed for this work. Such collections are intended to supplement others which have proved fruitless.

Finally, if all other methods fail, legal procedure is resorted to. Frequently, before this is done, the merchant may be permitted to give a note, which may be sold, thus shifting the collection to another party; but if the usual

ways of collecting are not successful, the account should be placed in the hands of a lawyer.

Usual Procedure.—After bills have been sent and there is no response, the collector should get together all the information he can about the debtor. He will find such facts ready at hand and classified by the credit department; and he can compare all data received from the various sources with the history of the account itself.

A correct knowledge of the customer's character, together with these facts, gives the collector power to deal intelligently with the case, and to know where it is safe to extend time or necessary to close legally.

If necessary, the investigation may be put into the hands of a collection agency, which is especially useful in small houses lacking the necessary organization to put proper expert service into collections. It should not be necessary with large houses.

Above all, collections should not be allowed to drag along, and if the customer does not ask for an extension, nothing should be taken for granted. Delinquent customers may be divided into four classes: The careless, the chronically slow, the temporarily hard up, and the insolvent. Policy makes it essential to understand under which of these classes each individual account falls. The customer may be really valuable to keep, and legal proceedings are expensive.

Law should be resorted to only after every other means has been exhausted. Bringing suit loses the customer either for cash or credit, and moreover it arouses his ill will, and habitual suit-bringing gives a firm or store a bad name in a community. Law invariably severs friendly relations, antagonizes the debtor and makes him determined not to pay if he can help it. If a debtor grows pugnacious, there should be not a moment's hesitation—suit should be brought at once. And in general, when legal proceedings are reached at all, they should be reached decisively. A large house should keep its own attorney for this purpose, familiar with its policy, and working rather for its ends than his own.

Foreclosure.—In instalment businesses especially, it is unwise to proceed to extreme action, such as foreclosing or seizure of the goods. Extension of time may be granted. There is rarely anything to gain by resorting to foreclosure. The goods are worn and will not bring their value, the customer is lost, the firm has the reputation in the neighborhood of being ready to pounce on whoever lets instalment day slip by, and the collector is greeted everywhere with black looks.

Originality in methods sometimes greatly helps the credit man in making his collections. Occasionally there will be a customer to deal with who is a little out of the ordinary run of the "dead-beat" class, and whom it might not be good policy to take any chances of offending by using the regular procedure for those who are hardened to such things. In such cases there is usually a way of getting at the debtor in some out-of-the-ordinary manner, the exact nature of which must be determined by the customer's temperament, his likes and dislikes, or perhaps some special hobby which he may have.

Banks as Collectors.—Banks do not as a rule care to handle collections, and if they undertake them, it is only as an accommodation to the creditor. There is no profit in it, and it is unreasonable to expect them to put themselves to any especial trouble. Many houses, however, expect to pay accounts through the banks by means of drafts drawn upon them, and conduct their business by affording this convenience to their creditors. The creditor thus makes his demand to the bank and avoids dunning and offending the debtor direct, while the money when received is in the safest possible hands for transmission. If, after an interval of holding, there is no payment, the drafts are simply returned as unpaid collections—marked "payment refused," or with the reasons for non-payment. If a draft is returned dishonored, then the handling of the matter from this point on depends entirely on the methods of the creditor and his relations with his debtor, and no general law of procedure can be laid down.

Collection Letters.—There is no branch of collecting which requires more subtle skill than collection letters. In general they differ from other kinds of business letters in being as impersonal as possible, so that the customer will not think that he is being persecuted or dunned, or that the money is particularly wanted, but that it is part of the simple machinery of business. The character of the letters depends entirely on the kind of persons addressed, and on the length of time since payment was due. The careless and habitually slow must be pricked into a sense of their business good faith. The temporarily hard up may be sympathized with, but must be made to realize that the creditor's position is also difficult, while the dead-beat must be threatened with the law.

The first letter, or the first few letters, should be extremely brief and impersonal reminders. The majority of firms send a second letter after an interval, and a number of notifications varying with different companies. This letter is longer and more urgent and is fitted to the character of the customer. It may be personal, sympathetic, confidential, or appealing. It may plainly and truthfully present the case, asking for a "square deal." A business man is generally amenable to fair treatment and will remit if he can. It may be simply a reasoning letter, making it understood that the basis of the credit system is that people can usually be depended on to pay their obligations. If it seems necessary, the letter may be peremptory.

If this avails nothing, it is generally followed by a final letter which should be short and to the point. It states simply that unless other settlement is made before a certain date the creditor will commence legal proceedings. It should be made clear that this will be done with regret, but that it will be done without fail or delay.

The collector should keep a concise abstract of all correspondence on cards of uniform size, which may be placed in a card file for ready reference.

XXII

DEPRECIATION

Definition—The Life of a Machine—Obsolescence—Other Depreciative Influences—The Accounting of Replacements—Charging Replacements to Capital—Depreciation Part of Producing Cost—Deterioration Other Than Physical—A Necessary Item—The Depreciation Reserve—Difficulties in Determining the Rate of Depreciation—No General Rule Possible—Study of Individual Plant Necessary—Of Equal Importance With Other Charges—Depreciation Records—Verification—Five Methods of Calculation—Results—Charging Off Depreciation.



Typewriter with Billing Attachment

Immediately above the operator's right hand are the adding devices, one being required for each column.

(See page 273.)

XXII

DEPRECIATION

THE growth of the modern science of cost accounting, marvelous as it has been, has served, in great part, merely to refine and make more accurate methods and processes long existent. The determination of the cost of the labor and materials expended upon a given product has been arrived at in a more or less crude way ever since production on any but the most primitive scale began. There is one element of cost, however, whose inclusion in cost accounting may justly be credited entirely to the modern accountant, the element of "depreciation."

Definition.—Depreciation is the shrinkage in the value of assets due to wear and tear, lapse of time, or obsolescence of type arising from the progress of new inventions.

Before entering into the discussion of the subject it may be well to note the distinction between "depreciation" and "fluctuation." The former is an impairment of value which in the ordinary course may be expected to take place as the necessary consequence of the possession and enjoyment of an asset; the latter, however, arises from causes entirely outside the scope of the business and may affect the value of its assets adversely or favorably.

A favorable fluctuation in the value of fixed assets seems to be a proper subject for a secret reserve, such as an appreciation in the value of land upon which factory buildings are erected, but it is not a conservative policy to write up the book value under such circumstances; a favorable fluctuation in floating assets is temporarily a

secret reserve which will be included in the trading profits when those assets are realized, but which should not be anticipated.

An unfavorable fluctuation in fixed assets need not, under normal conditions, be charged against revenue before declaring dividends out of current profits. It may therefore be disregarded in the accounts, but in order that the true position of affairs may be placed before the owners, it is desirable that attention be called in the annual report to the shrinkage in value. An unfavorable fluctuation in floating assets may be disregarded as long as there is reason to believe it to be of temporary character, but if it seems likely that conditions will remain unfavorable until the time comes for realizing those assets, then the loss should be charged against the period in which it actually occurred, rather than against the period in which it was realized.

In connection with this distinction between depreciation and fluctuation, it should be added that in some quarters the practice has been strongly advocated of occasionally having the fixed assets revalued as a check upon the annual provision for depreciation. There is much to be said in favor of revaluations, but it must be borne in mind that a revaluation can hardly fail to take into consideration fluctuation as well as depreciation, and consequently may introduce into the accounts a disturbing element, obscuring the real result of the operations of the business.

The Life of a Machine.—It is obvious to any one that if we take a "living" machine, as, for example, a horse, the value of that horse becomes continually smaller with advancing years. Given two horses with five years difference in age between them, but equal in all other respects, the younger one is worth more money; for barring accidents and extraordinary circumstances, it is practically certain that he will outlive the older. This is but another way of saying that a horse has a limited life and that, consequently, the more that period of life elapses, the less potentiality of usefulness the horse pos-

sesses, and the smaller becomes his value. In other words, a horse continually depreciates in value.

A machine of any kind has just as definite a period of "life" as a horse, and consequently is quite as liable to depreciation in value. When we see a machine running to capacity day after day for months, turning out enormous quantities of product without any apparent loss of efficiency, it seldom strikes us that the machine is in any sense being used. But every machinist knows full well, and every observer must with but little thought realize, that a silent lessening of the value of the machine is going on day and night. It may not now be apparent to the eye, but a day will surely come, must inevitably come, when the machine must be abandoned, when further repairs upon it will be useless and it will be reduced to its zero or residual value.

It is sometimes argued that if machinery be maintained in perfect repair it does not depreciate, and that, so long as its output does not fall off in quality or quantity, it is as valuable to its owner when ten or twenty years old as when new. This, however, is absolutely incorrect, for although a machine could, of course, be kept "alive" forever, by renewing its parts one by one as they wear out, supposing that it never grew obsolete, its value at any given time would depend upon the state of deterioration of its various parts at that time, because the effluxion of the life of each part is proceeding steadily from day to day. The same conditions apply to buildings as well as machinery.

Obsolescence.—There are, however, many ways other than physical deterioration by which a machine or building may become useless. Chief among these is what is often termed "obsolescence." A machine is said to have become obsolescent when an efficient or more economical machine is invented, making it uneconomical longer to use the old one. Innumerable instances could be given from almost any industry of expensive machines which became worthless soon after they were bought, owing to the invention of a much superior device. Especially is

this likely to be true of an industry which is yet in its infancy, and which is, therefore, peculiarly liable to the influence of revolutionary scientific discoveries. But no industry, however stable, is entirely free from the fear of its equipment becoming obsolescent.

Buildings must be no less considered than actual machinery. Nothing is more certain than that at the end of some indefinite period, perhaps long, perhaps short, a building used for manufacturing will become unserviceable or unsuitable for its original purpose. When that time comes, though the structure may be as strong as ever, it becomes almost valueless. For example, the substitution of a modern type of heavy high-speed machinery for an older type may necessitate the demolition of buildings that are still strong and otherwise thoroughly serviceable, but incapable of housing the new equipment.

While the "life" of a plant must be largely a matter of opinion and the expenditures on repairs and renewals must be taken into consideration in estimating it, it should not be forgotten that in the case of the majority of the units of plant, the tendency to obsolescence is the main factor to be considered. Not only is nature at work, but also science. Nature is constantly "breaking up to put together in other forms," and no amount of expenditures can postpone forever the day when science will take away from this asset its earning power.

There is also another kind of obsolescence to be feared by many businesses—an obsolescence not of machines, but of the demand which the machines supply. This applies particularly to those lines of business whose goods are affected by changes in style or fashion. The manufacture of millinery furnishes an excellent example of this. A millinery manufacturer may install, at great cost, a machine for manufacturing a certain kind of trimming. The next season, that trimming will be superseded by another; the machine immediately becomes valueless, and deteriorates through long years of disuse.

Other Depreciative Influences.—These factors, tending to make capital valueless, are present to a greater or less

extent in every business. Some industries, especially those commonly known as the extractive industries, are subject to still another depreciative influence. As time goes on, a mine is bound to become more expensive to work, a forest is almost certain to become denuded, and farm land is very likely to become exhausted. Whenever any of these things happen, the property in question obviously becomes less valuable.

One further factor tending to cause a diminution in the value of capital may be mentioned, that obtaining in connection with leased premises. When manufacturing is carried on in such premises, it is almost invariably necessary for the manufacturer to make certain alterations and install certain fixtures and machines, which he can not for one reason or another make use of in any other premises, and which, therefore, when the lease expires become a total loss to him.

To all these impalpable, intangible, imperceptible losses in the value of capital here described the general term "depreciation" is applied. Some form of depreciation is present in every producing business; whether observed and allowed for or not, depreciation unavoidably adds something to the cost of every article of manufacture produced. The proper accounting of depreciation, therefore, forms an essential part of any scientific method of cost accounting.

The Accounting of Replacements.—Until very recently, it was a common practise to charge the cost of replacing machines, or other capital which had depreciated in any of the ways above described, to the operating expenses for the year in which the replacements were made. It can readily be demonstrated, however, if indeed it is not self-evident, that this method of accounting does not correctly represent the facts of the case. If it actually represents not only the operating expenses for that year, but also the cost of replacing machines that were worn out through the use of the ten years previous, it furnishes no valid basis for comparison with the sales of that year or with the operating expenses of previous years. If,

on the other hand, it contains merely the actual expenditure for operation in that year, without taking account of the depreciation that the machinery and buildings have suffered during that period, it falls equally short of being a correct statement of the facts. It is required of every witness in a court of law that he tell not only the truth, but the whole truth and nothing but the truth. Similarly, the business man who desires a true statement of his producing costs for the current year will demand that his statement of operating expense show all this year's expense (including, therefore, loss due to depreciation), and nothing but this year's expense, omitting, therefore, the cost of replacement of machinery worn out through many previous years of service which were not recorded.

Charging Replacements to Capital.—Plainly, then, the cost of replacement of depreciated goods can not properly be charged to the operating expenses of the year in which the replacements are made. Realizing this to be true, especially of large replacements, some business men follow the practise of charging such large replacements to capital. In public service corporations, it frequently happens that the necessity for renewing, or in part replacing, their equipment is met by a new issue of stocks or bonds. This method of accounting for depreciation is equally or even more defective than that described above. The capital of a concern can not properly be said to have been increased by an expenditure, unless such expenditure has resulted in an increase, or an improvement in productive power also. When stock is issued against what is essentially only a replacement, it is evident that the concern must thereafter pay interest, not only on the cost of replacement, but also on the original investment upon the equipment replaced. At the same time, the productive power of the plant remains virtually the same. Comment upon the absurdity—from the point of view of either scientific accounting or of honest business—of this method of accounting for depreciation and renewals is surely unnecessary.

Depreciation Part of Producing Cost.—If, then, the cost of replacement is not justly chargeable to either current operating expense or capital, to what should it be charged? There can be but one answer: The cost of replacement should be charged to the operating expenses of the period during which the deterioration or depreciation which made replacement necessary took place. If a machine becomes valueless, from any cause, after ten years of service, the cost of replacing it should therefore be charged, not against the year in which it becomes valueless, but against all the ten years in which it was in service.

In ascertaining the cost of production, or manufacturing cost, one of the most interesting questions is that pertaining to depreciation. The method of providing for this charge and the amount of the same is the ever-fruitful source of differences which, when settled, affect the net results of profits of the period's transactions. A manufacturer produces goods for sale; production is the result of consumption; the value and amount of such consumption represents the gross cost of the article manufactured. The difference between the value of the material consumed and the value or quality of the article manufactured is the profit or loss of the manufacturer. The importance, therefore, of having the exact value of that which is consumed or the actual gross cost is readily seen to be indispensable. The raw material, labor and fuel charges, with any other expenditures, can be accurately ascertained, but in the actual manipulation of these things work has to be performed; work means wear, and the value of that wearing on the plant and machinery must be first approximated before the cost of the product can be determined. Raw materials, labor and fuel are absolutely consumed within the time occupied in production, while machinery and buildings are consumed over a lapse of years. Of the latter, from year to year, the exact value of the quantity remaining is known, therefore an amount equal to the difference between the cost and the estimate of the residual value of the buildings and machinery remaining after their useful existence is

distributed over the number of years of the estimated life. When a machine, or other capital, is employed in turning out a product, part of the value of that machine or other capital enters into that product as surely and as inevitably as does the material directly used in it, and the labor directly expended upon it, though such expenditure may not have to be met for another decade. The using of that machine is causing just as inevitable an expenditure as the purchase of raw materials, and the hiring of labor; and the sum which will inevitably have to be spent to replace that machine is just as truly a part of the cost of production as is the labor cost and the materials cost.

Deterioration Other than Physical.—While physical deterioration is the most important and most universal cause of depreciation, what has just been said of it applies with equal force to all other forms of depreciation above mentioned. If a machine, after having been used only a few years and while still almost new must be discarded and sold for scrap-metal because a superior machine has been invented, the cost of the machine is just as real an element in the cost of production of those few years' products as any other element that may be mentioned. In the instance stated of the millinery manufacturer, whose machine becomes worthless after one season's use through a change in the fashion, the cost of that machine certainly can not be considered otherwise than as an integral part of the cost of production of that season's goods, or rather of that particular line of the season's goods which the machine was used to make. Again, if a farm has been exhausted by ten years of yield, so that the expenditure of large sums for fertilizers is necessary to make it again productive, the cost of those fertilizers, and of the labor used in applying them, is essentially a part of the cost of producing the crops of those ten years. Lastly, if money has been spent in installing fixtures and machines which can not be used in other premises when the lease expires, that money can properly be considered only as

having been spent directly upon the production of the goods made within the period covered by the lease. And so, whatever example we choose, the conclusion is the same—the cost of replacement of capital which has been depreciated from any cause whatever is part of the cost of production of all the goods produced during the life of that capital.

A Necessary Item.—If this statement is true, if depreciation is properly a part of the cost of production, the necessity of including it in all calculations of the cost of production follows irresistibly. The scientific manufacturer in calculating his producing costs would as soon think of failing to include labor cost as to omit depreciation charges; for the former is no less a part of the producing than the latter. If depreciation is not calculated in cost of production, not only will the manufacturer labor under a false idea as to the rate of profit he is making; he will be very apt to cut prices lower than he can really afford, with fatal results. Mr. Charles W. Haskins, the prominent public service accountant, has said:

“This subject of depreciation is one of the most important, in my judgment, that an accountant has to contend with, and one that has very vital bearing upon the continuous operations of certain businesses. For instance, I have in mind that many telephone companies are started in different parts of the United States, capital is subscribed, and then a rate is fixed for the introduction of the service, based upon a very low rate for maintenance, and no allowance whatever is made for depreciation. This allows them, in the beginning of their operations, possibly, to meet their expenses from the revenue, but, as they continue, it is found that an increased charge is necessary for maintenance, and that renewals are necessary, with the result that many of the companies have gone to the wall because proper provision has not been made for renewals.”

The Depreciation Reserve.—The principle is then clear that the cost of replacement of a machine should be

charged up as a part of the operating expenses during all the years while the machine is used; or, in other words, the depreciation in any one year should be charged to the operating expense for that year. Since, however, the actual expenditure caused by depreciation—that is, the cost of replacement—is frequently not made until a number of years after the actual time of depreciation, the charge for depreciation can not represent an actual expenditure at the time of depreciation. To meet this difficulty what is known as a “depreciation reserve” is created. The amount of probable depreciation for the year is estimated as accurately as possible, and that amount is each year set aside as a fund, out of which the cost of replacements is sustained. The amount applied toward the depreciation reserve for the year is charged as a lump sum to the operating expenses for the year.

In this connection we refer to a valuable paper on “Depreciation,” by Herbert G. Stockwell, C. P. A., which shows that while depreciation reserve is simple in principle there is no uniformity in determining the rate of charges.

Difficulties in Determining the Rate of Depreciation.

—Among manufacturers there is no uniform practise regarding depreciation charges. The subject has been discussed by a number of associations of manufacturers, but no uniform practise is yet adopted.

By far the greater proportion of manufacturers do not consider the subject at all seriously. Others have in their minds that if any depreciation charges are made at all, the amount should be 10 per cent. This is heard from men dealing in iron and steel, wood and lumber indiscriminately. The idea of 10 per cent as a depreciation charge seems to have taken hold of the manufacturer's mind in the same way as the foundryman's rule that 10 per cent of the weight of pig-iron goes up the chimney.

Writers on the subject of factory cost have attempted to set up tables of average depreciation of different kinds of buildings and machinery. One of these estimates,

that on a worsted mill the annual depreciation charge should be based on the average life of the plant, is as follows:

- Wool-combing machinery, fourteen years.
- Worsted spinning machinery, ten years.
- Warping and beaming, thirteen years.
- Weaving machinery, twenty years.
- Scouring and finishing machinery, fourteen years.
- Dyeing machinery, fourteen years.

Another writer gives his views of depreciation charges as follows:

Milling buildings, $2\frac{1}{2}$ to 5 per cent on diminishing value.

Engines, boilers and gearing (if treated together), 4 to $7\frac{1}{2}$ per cent on diminishing value.

While these percentages form a rough guide to manufacturers, it will be seen that the range of annual charge, based upon the highest figure, would be 100 per cent greater than that based upon the lowest.

One of the difficulties of the general situation is the lack of harmony among those in control of the various public service and manufacturing corporations regarding the desirability of comparative figures. Those who would favor a comparison of their operating results with those of others are generally in such a position that a comparison would result in showing a favorable condition. Managers whose plants are not doing well would not favor a comparison of their results with the results of the more successful competitors. This is but an exhibition of human nature, yet it presents difficulties to the adoption of any uniform plan, because the larger portion of those by whom the plan must be honestly used to be effective would probably prefer not to be put in a position in which their weakness in operation would, by comparison, be disclosed.

No General Rule Possible.—It seems impossible to avoid the conclusion that no general rule for depreciation can be formed so that it will be applicable to all kinds of industries. Even in any one particular line, the condi-

tions under which plants in different sections of the country are operated vary so that, while it is possible to obtain a rough average length of life of the machinery used in that particular line, the average will not constitute a proper basis for guidance in any one of the plants included in the figures producing the average. The various climatic conditions in some portions of the country cause much more rapid rusting of metals than that of others; the extremes of heat and cold, and the variations of humidity, produce different effects upon machinery to a remarkable extent.

While from a statistical standpoint it would be interesting to know the average depreciation in machinery in any particular line, it would not be of any practical use, for the reason that the proper depreciation in each particular plant would necessarily be either above or below the average. If any arbitrary figure would be adopted by one of the plants whose figures produced the average, the result in the operating expenses would be to show false conditions; then again, machinery of the same kind built by different manufacturers, used with as nearly the same degree of care as possible, will vary in life. Furthermore, one of the most important things affecting the operation of the factory is the personal equation of the management. Very few people take this into sufficiently serious account. The management in one factory may give close personal attention to the condition of the plant, watch the operation carefully, and have competent assistance to study the conditions under which the machinery is operated, and see that it is carefully handled. In another plant, the management may give little thought to such things, and their simple demand may be that goods be produced, without regard to the effect upon the plant.

Study of Individual Plant Necessary.—It can be confidently asserted that there are no two manufacturing plants in which the management is sufficiently identical in character, ability, and temperament that a depreciation charge in the same amount or on the same per-

centage basis could be correctly used in both. This being true, how useless it is to attempt to form averages for the life of machines in all plants, even in the same lines of business.

The only way that the annual amount of depreciation can be determined is by a study of each individual plant, and the application of the figures representing the depreciation to that individual plant and no other. To say that it is absolutely impossible to figure depreciation in advance is true. This is a statement that comes under a general proposition that the actual value of no asset can be determined until it is converted into cash. Some will say that the market value of stocks and bonds is fixed and can be determined, but any one who will take the trouble to inquire of a banker will learn that an effort to sell any considerable amount of stocks and bonds at the quoted figure will immediately produce a change in the quotations. Any statement of values of property, real or personal, prior to being converted into cash is, and must be, estimated pure and simple. It is nothing but the expression of the opinion of the man making the estimate. If the appraisal is made of a going concern, the idea is not that it would bring, if put on the market to-morrow, the particular sum appraised, but that it ought to bring to-day the figure at which it is appraised, provided conditions for the disposal of the plant are favorable. Unless the plant has shown great earning power, it is hardly likely that buyers would pay the full cost of the plant as shown on the books, even though a reasonable amount of depreciation has been taken into consideration. If the earnings have been no more than ordinary, it is more than likely that a sacrifice would have to be made by the owners in disposing of the plant, so that any statement of the condition of the plant, whether made from the books with due consideration to depreciation or whether made from an actual appraisal, is simply an expression of the opinion of the party making the statement.

If that estimate is actually entered into and made in a way calculated to show the result of good business dis-

cretion, that is all the directors of a corporation need do so far as the law is concerned; and if they do that, what more need they do to fulfil all requirements of business calculations? No man can foresee the future, but if he relies upon that as a complete answer to his neglect to make some attempt to provide for the future, he will surely find himself in a position to be criticized.

Of Equal Importance with Other Charges.—In no manufacturing plant of any consequence would it be considered the part of wisdom to neglect to take an account of stock of supplies, raw materials, manufactured and partly manufactured goods, at least once a year. Whatever the books may show, the actual test is considered necessary, in order that the various assets may be found intact. How carefully the cashier of a corporation balances his cash! He is not satisfied to glance at the balance shown by the cash-book. He must verify the fact that the actual cash is on hand or in bank. How many cashiers will remain at the office after hours, searching for a few cents difference in the cash! The book value is not satisfactory to them. The actual amount of cash must be counted, and must correspond with the book value. If any overs or shorts exist, the book value will be adjusted if the error can not be located. The same thing is true of stocks of merchandise, materials, etc. If the goods are not there upon actual count, and the discrepancy can not be located, the book values will have to be adjusted to correspond.

But besides the question of the actual loss of the article itself, the values of the stock are carefully scrutinized, and the book values adjusted thereto, and the stock book of raw materials and manufactured articles is carefully examined periodically and the book records adjusted. This principle extends to the value of customers' accounts. Few up-to-date corporations would issue a statement showing the aggregate of the accounts receivable to be worth face value, without any allowance for actually or possibly doubtful accounts.

The president of a corporation will not be satisfied

that the stock on hand and book accounts are carried at a proper value if that value shown is the original cost. The plant values should no more be carried at cost without due allowance for depreciation than the value of any other asset, unless the cost represents the value at the time the statement is made.

The directors of a corporation having a million dollars invested in the plant should keep a strict account of the various items making up that plant, a record of the exact location of the articles, the date when purchased, and the amount of estimated depreciation thereon. There is no reason why just as much care should not be taken of the various buildings and machines, tools, etc., as is taken in the articles making up the book accounts, cash and stock. If this is conceded, it seems to point to the only sound way of obtaining the annual depreciation charge.

Depreciation Records.—A card record should be made of each and every article of value in a plant, showing the date when purchased, the cost, amount of repairs, and estimated annual depreciation. It is not possible to lay down a general rule as to the extent to which this principle should be carried out in detail. In some plants it will be found to be practicable to group items of a similar nature, and having practically the same amount of depreciation. In others it will be found practicable to carry it out so far as to show each and every line of shafting, pulleys and belts thereon, and all small tools. The idea will immediately occur to the minds of some readers that if applied this principle would call for thousands of cards in the office. What if it does? Each one of these cards will represent a value of from several dollars to several thousand dollars, and should be just as carefully accounted for as the nickel in the cashier's box, or the brass, steel, wool, or wood in the storekeeper's bin or rack.

A ledger in which accounts would be kept, showing the aggregate of the items composing the plant in various groups or departments, would enable the annual depreciation charge to be shown in subdivided summaries,

which, added together, would produce: (a) The aggregate value of the plant as shown on the books; (b) the aggregate amount of repairs made; (c) the aggregate amount of the annual depreciation; and the total of all these to any particular date. The figures for these items can not be obtained from the experience of any other plant than the one in which the calculation is made. No averages made up of figures for the same line of industry will be accurate. These figures must be thought out and adopted by the officers of each individual corporation for its own plant. While a comparison of all in the same line will be useful in ascertaining whether the individual plant under operation is charging off more or less than the average, that is the extent to which the average figures will be useful; and these average figures will not be of any value unless the figures producing the average are made up from plants existing under similar conditions.

Verification.—In order that the estimates may be verified, frequent detailed appraisements of all the plant items should be made. It would be difficult to say just how often the appraisement should be made. In some plants every five years will be often enough. In others, more frequent examinations will be necessary.

When the amount of estimated depreciation is determined, then the charge on the books should be made to the proper operating expense account, the credit being to an account called "Depreciation Reserve," or some similar name. That depreciation is a cost of operating seems clear, for the reason that a plant operated for any definite period and sold would bring less money than it cost. This refers to the plant assets as such. The questions of good-will and increase of value of real estate are not to be considered in the comparative value at the beginning and ending period of the assets comprising the plant.

In other words, it is beyond reason that buildings and machinery, after use for any period, will realize as much as they cost. The use of them has caused a depreciation,

even if idle part of the time. It must follow that to the cost of production of the goods must be added the shrinkage in value of the buildings and machinery in any statement of the result of the wind-up of the plant.

Five Methods of Calculation.—The five usual methods adapted to providing for depreciation are as follows:

1. By a fixed proportion of original value,
2. By a fixed percentage of reduced balances,
3. By an annuity system,
4. By a sinking-fund,
5. By an annual revaluation.

(1) The fixed proportion method distributes the depreciation by equal instalments over the period. (2) The fixed percentage method throws the greater part of the depreciation on the first few years. (3) By the annuity system the gross charges in respect to depreciation are constant, but the credits to revenue, in the shape of interest, diminish from year to year as the value of the asset decreases. (4) The sinking-fund method is, perhaps, the most scientifically correct.

The first method is very generally used and can be applied to most concerns. The second method, throwing the greater part of the cost on the first few years when the efficiency of the asset is greatest, works to a distinct advantage in a number of cases and ways, especially where machinery is subject to sudden mechanical improvements, thereby necessitating replacements in order to keep up the plant efficiency. The third method has its advantages, but is rarely used in this country. The fourth method is not extensively applied by manufacturing and similar concerns for a number of reasons, one of which is that the capital invested in their own business earns a far larger amount of interest than can be secured by the outside investment of a sinking-fund. Besides, if depreciation is kept in the shape of a reserve account, the amount of which may be invested in outside securities, this answers practically the same purpose. Revaluation may be considered a fifth method of allowing for depreciation, but it is not advisable.

The following illustration will show the result of the other four methods of depreciating, assuming that (a) a machine has been bought and set up at a total cost of \$1,000; (b) its estimated life is twelve years; (c) the break-up or residual value is \$100; (d) the net cost, \$900, is to be apportioned.

RESULTS

<i>End of</i>	<i>Method 1</i>	<i>Method 2</i>	<i>Method 3</i>	<i>Method 4</i>
First year.....	\$75.00	\$175.00	\$53.35	\$53.58
Second year.....	75.00	144.37	50.55	53.58
Third year.....	75.00	119.11	59.94	53.58
Fourth year.....	75.00	98.27	63.54	53.58
Fifth year.....	75.00	81.07	67.35	53.58
Sixth year.....	75.00	66.88	71.39	53.58
Seventh year.....	75.00	55.18	75.68	53.58
Eighth year.....	75.00	45.52	80.22	53.58
Ninth year.....	75.00	37.55	85.03	53.58
Tenth year.....	75.00	30.98	90.13	53.58
Eleventh year.....	75.00	25.56	95.54	53.58
Twelfth year.....	75.00	20.51	101.28	53.55
Compound interest, 6%...				257.07
	<u>\$900.00</u>	<u>\$900.00</u>	<u>\$900.00</u>	<u>\$900.00</u>

The figures are to be obtained as follows:

Method 1. Ninety per cent of the cost spread over twelve years equals $7\frac{1}{2}$ per cent per year.

Method 2. The fixed percentage on reduced balances is $17\frac{1}{2}$ per cent in this case.

Method 3. The interest, 6 per cent, is charged to the asset, and a constant equal sum—sufficient to reduce the asset to zero or its residual value—is written off each year. The net result is the charging off of an increasing sum to revenue, and its justification is that the depreciation instalments remain in the business and thereby increase the working capital of the undertaking.

Method 4. The sinking-fund method hardly needs any further explanation, except that in this case the compound interest has been figured at 6 per cent.

Any of these methods may be employed, and, in case of the first two, instead of crediting the asset with depreciation direct, thereby reducing the amount on that particular account, it has been found advisable to leave

it intact during the whole life of the asset by having a depreciation reserve account. In this case this reserve account is to be credited and revenue debited with the amount of depreciation. This reserve stands as a liability against those assets depreciated, but left intact on the books, and may either be used in the business or invested in outside securities. In the latter event, this reserve may serve the purpose of a sinking fund, with the additional advantage that no fluctuation of interest in the future will affect it, because interest has not been considered at first, and the earnings on such outside investments are taken into revenue direct.

Charging Off Depreciation.—Whether the annual depreciation can be charged off in twelve equal monthly instalments depends entirely upon the character of the business. In some lines of manufacture, heavy depreciation will undoubtedly take place in certain months of the year. In some plants undoubtedly depreciation will go on to a greater extent when the plants are idle or partly idle than when running to full capacity, while in the other plants one month's operation is very similar to another, and it will be possible to establish an equal monthly rate. After the aggregate of the estimated depreciation for one year is ascertained, it then will become a matter of dividing the charge into such subperiods as are found most useful in showing exact results.

There are many classes of business in which it is not practicable to show a monthly or even a quarterly profit and loss account, and it would seem to be unwise to attempt a matter of bookkeeping which would produce no accurate or valuable information to the management. Of course, in some lines of industry, particularly those engaged in large contracts, such as ship-building, or construction of factory and office buildings, where one or two large contracts of that nature compose the principal activity in which the corporation is engaged, there would seem to be no natural closing period; but the general experience of business men calls for at least one annual balancing and settling up of every possible account.

XXIII

INTEREST AND DISCOUNT

I. INTEREST

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2. DISCOUNT

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XXIII

INTEREST AND DISCOUNT

I. INTEREST

INTEREST may be defined as the price paid for the use of money. As used by economists it is the price paid for the use of *capital* (money or other form of capital). It is identical with the first meaning of the word *usury*, which originally meant, not, as to-day, exorbitant interest, but any interest at all, usury being what was paid by a debtor to a creditor for the use of money. When the Old Testament forbids usury, it really refers to interest—the taking of any price for the use of money—though the Mosaic law did not forbid one to take it from a stranger. The evil significance of the term in later years arose from the fact that the aristocratic money lenders of Rome, in spite of laws to the contrary, charged exorbitant rates of interest to the provincials.

Early View of Interest.—In primitive societies the idea of charging anything for the loan of capital was repugnant, and almost an unknown practise. This repugnance is easily understood when it is remembered that in early stages of civilization loans were employed, not as capital for profitable production, but for consumption, and were consequently desired only by persons in want. It was thought that to take advantage of another's necessity, by asking something more than was given, was shameful. In mediæval England the taking of interest existed, though condemned on principle, the chief money lenders being of the Jewish race. In the reign of Edward VI, 1552, a bill forbidding interest was passed, and remained until altered by Queen Elizabeth, who set the rate at 10

per cent. In France interest did not become legal until the Revolution, having been forbidden on commercial loans, though the flourishing city of Lyons was exempt from this rule.

Jeremy Bentham, the great political economist of the 18th century, argued that it was justifiable. His celebrated argument was that the effort to condemn and forbid interest simply raised the rate of interest. Men at times must borrow. The lender does a real service to the borrower. Under equity he is entitled to some reward or interest. If all interest is forbidden, he will then secretly ask a higher rate of interest because of the risk he runs. It is also argued by others who share his views, that the attempt to control interest places useless and harmful checks on the natural flow of civilization.

In Germany, as late as 1880, a new act against usury was passed, and amended and extended in 1893. It is now a criminal offense to obtain a profit by taking advantage of the necessitous condition or inexperience of any person, in reference to loans or other transactions which exceed the usual rate of interest, in such a way that the profit seems out of all proportion to the service rendered, "and all transactions of this nature are null and void." It is also a criminal offense to carry on business as a usurer.

To-day civilization is largely based on the use of interest, and few but the extreme radicals condemn it; and it has been said that to destroy interest would be to harm the worker and overthrow civilization.

Interest on Capital.—Professor Bullock, discussing capital, says:

"The payment of interest for a loan of capital is not explained by simply showing that capital serves to increase production, to improve the quality of the product, and to secure products that would be unattainable otherwise. If men would be willing, without receiving interest, to accumulate enough capital to carry on the business of the world, then no one could secure interest. But this is something that can not be expected. If a

person has \$1,000, he can expend it for customers' goods that are available immediately. If he invests it in capital, he can secure a return only after some time has elapsed. When he invests \$1,000 in productive capital, he converts a present available income into such a form that it is available only in the future. Now, persons will not exchange a present income of \$1,000 for a future income of only \$1,000. This is for two principal reasons: First, the future is always more or less uncertain, and 'a bird in the hand is worth two in the bush.' Second, even when the uncertainty and risk of the future are reduced to a minimum, most persons underestimate or undervalue future pleasures or pains. But many people are willing to invest \$1,000 of income in capital so that it will be available for a year, in return for \$1,050 at the end of that period. The \$50 premium would be interest in this case. It would be a premium added to the principal of the loan, available only at the end of the year, in order to make it equivalent to a present income of \$1,000. Interest is paid, therefore, as a premium to equalize future goods or future income with present goods or income, in the estimation of possible investors. Capital formation implies a willingness to invest present income in producers' goods that are available only in the future. Interest is the inducement necessary to insure the formation of enough capital to meet the needs of business.

"Capital may be furnished by three classes of persons: First, it may come from rich persons with large incomes, who can easily save large amounts of income and invest them in capital. Second, it may be supplied by persons of moderate means who wish to provide for the future, and would do so even at very low rates of interest. Both of these classes of investors do not require large premiums in order to induce them to convert part of their present incomes into capital. In the third place, we have marginal investors, who will furnish more or less capital according to the inducements offered for its investment. These may be wealthy persons, or may be people of moderate means, who would save and invest a portion of their incomes even at low rates of interest. But they will

save more, and furnish more capital, if the premium offered for investments is high enough to make it worth while.

"The demand for productive capital comes from all the industries that are needed to meet the wants of society. The demand will be large in proportion to the energy and enterprise of the population in all branches of economic activity. Again, the demand will be stimulated by the natural opportunities offered for favorable investments. Both of these causes have made the demand for capital very active in the United States.

"The rate of interest is really the rate of annual income that will equalize future income with present in the minds of those persons who furnish the marginal portion of the supply of capital needed to meet the demands of the business of a society. In other words, we have merely another case of the equalization of the supply and the demand through changes in price—in this case 'price' meaning the premium offered for future goods or income. Prices of commodities must be high enough to enable the marginal investors of capital to secure a premium, or rate of interest, that will induce them to furnish the amount of capital required."

Three Factors in Calculating Interest.—In every calculation of interest there are three factors, viz., principal, rate, and time. With regard to the amount on which interest is to be calculated, i. e., the principal, no question can well arise, as this must be definitely fixed before a calculation can be made. The rate—usually expressed on a per annum basis—is indirectly affected by the stating of the time or period for which the interest is calculated, but in itself is really only capable of one application. It is therefore with regard to the third factor—that of time—that the greatest divergence of method is found. Hence, it is in order to note the different ways of stating the time in a given period for which the interest is to be calculated, with the related question of the unit period of time on which that calculation is intended to be based.

Different Methods of Computing Time.—A question on which there has been much debate and difference of opinion, and on which there is a divergence in the usages of financial institutions, is as to whether both the first and last days, or only one of them, should be included in stating the time included between two given dates. The following extracts from a digest on the subject, from a legal standpoint, are of interest:

“There seems to be one general rule with reference to counting the first and last days in the computation of a period of time which, subject to exceptions based upon the language of the provision for time, or upon the surrounding circumstances, seems to have remained the same throughout the whole period of the common law, and which remains practically the same under the statutes and rules of court. That rule is that in the computation of time of the first and the last days of the period one shall be included and the other excluded. The question as to which of the two days shall be included and which excluded, however, has been differently decided in different periods of different jurisdictions, and has given rise to much conflict of opinion. The general common law as it originally existed was that the first day was to be counted when the computation was to be from an act or event, but that it was not to be counted when the reckoning was to be from a day or from the day of an act or event. The more modern decisions have changed this rule and in the absence of a statute or rule of court controlling the question, the courts now compute time, as a general rule, by the excluding of the first day and including the last.”

With particular reference to negotiable instruments, the digest continues:

“The general rule under the statute, as well as at common law, is that in computing the time that a note payable at a future day has to run, the day of the date is excluded.

“In computing the time when a note or bill payable at a certain number of months after date will become due, the rule is to exclude the day of the date from computation, and include the day of payment when no days of grace are allowed, and the note will become payable on

the same day of the stipulated month as that of its date.” (Blanchard *vs.* Hilliard, 11 Mass., 85.)

It will be noted that the foregoing statements as to negotiable paper relate more to the determination of the time as affecting maturity or due date of an instrument than to the time for which the interest shall be paid. It would seem, however, that the same rule would apply to the determination of either question, and if a note is drawn at three months, the accruing interest should be paid for a period of three months, no more and no less.

Varying Practise of Banks.—The practise among banking institutions varies in calculating interest or discount on loans, some including both day of date and due date, others only one of the two, while still others include both days when a loan is first made, but only one of the two days on renewals. It will be observed that where the practise is to include both days it results in charging interest twice for the day on which a renewal note is given to take up the one maturing. The argument usually advanced to justify this duplication is that the result would be the same if the borrower were to obtain a loan at another bank (paying interest for both days) and use the proceeds to pay the maturing note.

This curious lack of uniformity is carried a step further when banks, which charge interest for both first and last days, do not allow interest on deposits on the same basis. As the officer of a large trust company expressed it: “We allow interest on the basis which requires us to pay out the least money,” and had he gone on to refer to the basis of charging interest on loans he would doubtless have stated quite as frankly that “we charge interest on the basis which brings us in the most money.” Such a course, however, is certainly not equitable.

The Fairest Rule.—On the whole, the fairest rule would seem to be to exclude either the first or last day from the period of time for which the calculation is being made. In Kirkbride and Sterrett’s “The Modern Trust Company” (page 84), the rule is stated thus:

"In computing interest on loans the actual number of days is taken. If the day on which the loan was made is included, the day of payment is not counted." While a New York University professor solves the problem by saying, "Count the number of *nights*."

The principle is the same in any business or transaction involving interest. Interest on a bank account would naturally be calculated on the same basis as negotiable instruments. In commercial houses the custom is to include either the first or last day, not both, in making interest calculations.

The Unit Period.—The second question relating to the factor of time is, as has already been mentioned, the unit period on which the calculation is based. Interest rates are usually stated on an annual basis, i. e., they are expressed as a percentage of the principal which is to be added to it for the use of this sum for one year. Even when the rate is not stated as so much "per annum," it is, unless expressly stated otherwise, usually so understood.

Payments of interest made periodically in pursuance of an agreement do not, as a rule, raise any question concerning their calculation. If monthly, quarterly, or semiannual payments, they are simply one-twelfth, one-fourth, or one-half of the interest for a full year. But in the case of interest for fractional or odd periods of time varying methods of calculation are encountered. Theoretically the correct method would be to ascertain the number of days, and take this number of 365ths of a full year's interest. Some banking institutions use this method, though by far the greater number base their calculation on a year of 360 days. The latter method is most convenient, but when interest tables are not used one method is just as simple as the other.

Many States have by statute legalized this banking usage; in others it is permitted or obtains merely by force of custom. In the revision of the statutes of New York in 1892 the statute legalizing the 360-day basis of interest was dropped, and at the present time this method of calculating interest, when the maximum rate is

charged, is technically illegal in that State. Under an act of the Massachusetts Legislature, approved on March 6, 1909, interest on all loans of money and on all bonds and notes purchased or held by the commonwealth were thereafter to be computed on the basis of 365 days to a year instead of 360 days.

Calculating by Months.—In calculating interest for a part of the period for which it may regularly be paid, say quarterly or semiannually, as on bonds or mortgages, the time is more frequently stated in months and days than entirely in days. In such a case the number of full months from the date to the same numbered day next preceding the final date should first be determined, and then the odd days to the final date.

The months, irrespective of whether they have 30 or 31 days, would be treated as so many twelfths of a year, but as to the odd days there is a variation in treatment, sometimes being taken as so many 30ths of a month (equivalent to a 360 day basis), and sometimes being figured as so many 28ths, 30ths, or 31sts, according to the month in which they occur.

Still another method of dealing with the odd days would be to consider them as 365ths of a year. Either the first or last method would seem preferable, the first (treating them as 30ths) having the merit of consistency, as it brings the treatment of the full months and the odd days more nearly on the same basis, though the last is doubtless more strictly in accord with the law in those States which have no statute legalizing the 360-day basis.

Interest on Deposits.—Savings banks frequently have rules concerning the interest to be allowed on deposits which provide for certain concessions or the reverse. Deposits made on any day between the first and fifth may be permitted to draw interest from the first of the month, while deposits after the fifth may not draw interest until the following month. In some cities where the savings banks and trust companies allow a rate of interest on time deposits which is higher than obtains in any other

cities, they have rules concerning the calculation of interest which result in reducing materially the average rate actually paid on deposits. These rules in one large city are as follows:

"Deposits from the second to the fifteenth of the month draw interest only from the fifteenth of the month; deposits from the sixteenth to the first of the following month draw interest only from the latter date.

"Withdrawals during any semiannual interest period lose all interest accrued thereon since the last interest date."

The first rule is not any more severe than the rules usually obtaining, as it is quite a general custom to allow interest on savings deposits on full calendar months. The latter rule, however, is the one which accomplishes the greatest reduction in the rate of interest actually paid. A large sum of money withdrawn after having been deposited for, say five months since the last interest date, receives no interest whatever for the period in question.

Five Equitable Rules.—The following rules on points concerning which there is a variation in practise might be formulated as being the most accurate and most equitable to all parties concerned:

1. In stating the time between two dates, include only one of the two days, not both.

2. For interest payable at regular intervals, as semi-annually, quarterly or monthly, such periods should be considered as one-half, one-quarter or one-twelfth, respectively, of the year.

3. For a fraction of any of the foregoing periods, the time should be stated in months and days, each month being considered one-twelfth of a year, and the odd days as 30ths of a month.

4. When interest is calculated for the actual number of days in a period, it should be taken on the basis of 365 days to the year.

5. Where a definite and well-understood custom exists of charging and paying on the basis of 360 days to the

year, this method should be used for calculating days, but the custom should be thoroughly known to both parties.

Rules of the United States Treasury Department.—It may be of interest to note the rules for calculating interest which obtain in the Treasury Department of the United States Government. Their substance is as follows:

Only one of the two days of date and due date of obligation is taken into account in stating the time for which interest is to be calculated.

When interest is payable semiannually or quarterly, one-half or one-quarter of a full year's interest is apportioned to the period in question.

In calculating interest of a fractional period, the time is the true fraction of that period. For an annual rate, the time is the exact number of days for which the interest runs, divided by the number of days in the year, 365 or 366. For a semiannual or quarterly period, it is the number of days for which the interest runs, divided by the number of days in that particular half year or quarter year.

Unless the unit period is a month the month does not enter into interest computations; only days and the full unit period being considered.

In conclusion, this subject can be robbed of its vagueness and lack of uniformity in procedure only by a working agreement among banks, trust companies, and business concerns generally. There is no reason why a set of rules equitable to all persons should not be drafted, covering the computation of interest, and if necessary incorporated into the laws of the various States.

INTEREST TABLE

The following is a summary of legal rates of interest prescribed by the statutes in the different States, with the maximum rates allowed by special contract between the parties, and the penalties imposed for usury.

<i>State</i>	<i>Legal rate</i>	<i>Maxi- mum rate</i>	<i>Penalty for usury</i>
Alabama	8	8	All interest forfeited
Alaska Territory . . .	8	12	Forfeiture of double interest
Arizona	6	12	No penalty
Arkansas	6	10	Principal and interest forfeited
California	7	No limit	No penalty
Colorado	8	No limit	No penalty
Connecticut	6	6	No penalty
Delaware	6	6	Forfeiture of a sum equal to the money lent
District of Columbia .	6	10	All interest forfeited
Florida	8	10	All interest forfeited
Georgia	7	8	All interest over 8% forfeited
Idaho	7	12	Interest and 10% per annum of principal forfeited
Illinois	5	7	All interest forfeited
Indiana	6	8	All interest over 6% forfeited
Iowa	6	8	Interest and 8% per annum of principal forfeited
Kansas	6	10	Forfeiture of all interest in excess of 10%, and also an amount equal to the excess contracted for
Kentucky	6	6	All interest over 6% forfeited
Louisiana	5	8	All interest forfeited
Maine	6	No limit	No penalty
Maryland	6	6	All interest over 6% forfeited
Massachusetts	6	No limit	No penalty
Michigan	5	7	All interest forfeited
Minnesota	7	10	Principal and interest forfeited
Mississippi	6	10	All interest forfeited
Missouri	6	8	Excess of interest forfeited
Montana	8	No limit	No penalty
Nebraska	7	10	All interest forfeited
Nevada	7	No limit	No penalty
New Hampshire	6	6	Forfeiture of three times the excess of interest charged
New Jersey	6	6	All interest forfeited
New Mexico	6	12	Forfeiture of double the interest, and fine of not less than \$25 and not over \$100
New York	6	6	Principal and interest forfeited. Call loans allowed higher rate.
North Carolina	6	6	All interest forfeited
North Dakota	7	12	All interest forfeited
Ohio	6	8	Forfeiture of excess of interest
Oklahoma	6	10	All interest forfeited
Oregon	6	10	Principal and interest forfeited
Pennsylvania	6	6	Forfeiture of excess of interest
Rhode Island	6	No limit	No penalty
South Carolina	7	8	All interest forfeited
South Dakota	7	12	All interest forfeited
Tennessee	6	6	Forfeiture of excess of interest and fine
Texas	6	10	All interest forfeited
Utah	8	No limit	No penalty
Vermont	6	6	Forfeiture of excess of interest
Virginia	6	6	All interest forfeited
Washington	6	12	Forfeiture of excess of interest
West Virginia	6	6	All interest over 6% forfeited
Wisconsin	6	10	All interest forfeited
Wyoming	8	12	All interest forfeited

2. DISCOUNT

A subject closely related to Interest is that of Discount; in fact, as we shall show, in some instances the two are different terms for the same thing. Discount is commonly recognized as an allowance or rebate for prompt payment upon a bill not yet due; or the difference between the face value of a note and its net proceeds in cash.

There are three forms of discount commonly recognized, viz.: (1) Bank Discount; (2) Cash Discount; and (3) Trade Discount.

1. Bank Discount.—Discount as an important factor in banking practise is money paid in advance for the use of money. That is, it is interest paid in advance. One of the principal functions of a bank is the discounting of bills and other negotiable paper. The maximum legal interest permitted to be charged is generally fixed by State law, and banks charging rates in excess of those authorized subject themselves to certain penalties. Banks may purchase notes if provision is made in the charter, but may not demand more than the lawful rate of interest as profit.

To collect interest in advance, or to "discount," actually results in a rate of interest, when calculated on the amount actually received by the borrower, higher than the nominal rate. When the nominal rate of discount is the highest rate of interest permitted by law—and a large majority of States have fixed the maximum rate which may be charged—technically it becomes a usurious transaction. In general it must be regarded as well established that, at least on short-time paper, interest may be taken by way of discount in advance, and at the highest rate allowed by the law, although this does in reality make the interest paid, if computed on the amount actually received for use by the borrower, exceed the legal rate by the amount of interest upon the interest for the time of the debt.

Recognized by Law.—The right to take interest in advance is expressly given to the national banks by United States Revised Statute, No. 5197, which fixes the rate at seven per cent, in cases where no rate is fixed by the law of the State, territory or district where the bank is located. But it also provides that banks shall not take greater interest than the local law permits, except when such laws fix a different rate for the State banks of issue, and then such rate is allowed to the national banks. There have been decisions in which discount, or interest taken in advance for a period of one year or even longer, have been held to be not usurious in a strict sense.

The laws of New York expressly provide that a bank or banker may deduct interest in advance. Every bank and banker doing business in this State may take, receive, reserve and charge on every loan and discount made, or upon any note, bill of exchange or other evidence of debt, interest at the rate of six per centum per annum; and such interest may be taken in advance, reckoning the days for which the note, bill, or evidence of debt has to run.

“The knowingly taking, receiving, reserving or charging a greater rate of interest shall be held and adjudged a forfeiture of the entire interest which the note, bill of exchange, or other evidence of debt carries with it, or which has been agreed to be paid thereon. If a greater rate of interest has been paid, the person paying the same, or his legal representatives, may recover twice the amount of the interest thus paid from the bank or other private individual banker taking or receiving the same, if such action is brought within two years from the time the excess of interest is taken. The purchase, discount or sale of a bona-fide bill of exchange, note or other evidence of debt payable at another place than the place of such purchase, discount or sale, at not more than the current rate of exchange for sight draft, or a reasonable charge for the collection of the same in addition to the interest, shall not be considered as taking or receiving a greater rate of interest than six per centum per annum.”

The true meaning of this section is to place banks and bankers on an equality in this respect with the national banks as organized under the Act of Congress entitled, "An act to provide a national currency secured by pledges of United States bonds, and to provide for the circulation and redemption thereof," approved June 3, 1864.

Discount on Bonds.—Bonds can be issued at a discount. Where they were issued for construction purposes, it was usual (particularly among railroads and public service corporations) to capitalize the entire discount, on the theory that it really represented actual additional cost of property for which the proceeds of the bond sale were used. In fact, prior to July 1, 1907, when the Interstate Commerce Commission's revised classification of accounts went into effect, this practise was general.

It is becoming recognized, however, that discount on bonds is after all only an adjustment of the interest rate—whether due to insufficient security of principal, or to a nominal rate of interest lower than the ruling market rate is immaterial—and that such discount should be charged off to Revenue.

Amortization.—The scientific method of dealing with the discount (termed amortization) is to write it off in instalments during the life of the bonds, so that the aggregate of the discount and the nominal interest charged to revenue account is the actual amount of interest paid on the proceeds of the bonds. Where, however, an extremely conservative management chooses to write off the discount over a much shorter period than the life of the bonds, or even in one year, no valid objection could well be raised. The Public Service Commission of the State of New York (Second District), in the uniform systems of accounts recently prescribed for the various classes of public service corporations under its jurisdiction, expressly forbids the charging of discount on bonds to any account representing the cost of property, and directs the discount to be amortized or, if desired,

written off in a shorter period than the life of the bonds themselves.

2. Cash Discount.—Cash discount is an abatement or margin allowed upon an account at the time of payment. Discount of the nature of interest is an extra allowance, or discount, allowed from an account for payment in cash, before the debt is due, or before the expressed or implied term of credit has expired. Though called a “cash” discount it does not necessarily follow that a payment must be made in cash, as 2 per cent discount is often allowed when an amount is paid (even overdue) by a thirty days’ note, and in the latter case sometimes interest at 6 per cent per annum is added to the amount of the note for the time it is running.

3. Trade Discount.—That important branch of discounting known as trade discount may be defined as a special allowance, reduction or abatement in price, or a special advantage in price, offered by the manufacturer of an article to the merchant, factor, or retailer, which is agreed upon at the time of sale, and has reference to the mode or time for payment.

Differences between Cash and Trade Discount.—Trade discount affects the retailer’s selling price, and has to be first considered before that can be ascertained.

A cash discount as a rule is of so small a percentage as to be discarded in basing selling prices, and therefore may be said not to affect it.

The profit on a trade discount is a gain in the buying and selling department of a business; a cash discount in the financial department.

A trade discount precedes a cash discount, the former being deducted from gross price, while the latter is allowed from the residue.

Trade discounts are allowed on manufactured goods, but not as a rule on raw materials or natural produce.

While cheap or dear money may affect those trade discounts which include cash discounts also, as a rule it

does not directly affect discounts generally, but it has an influence on cash payments and discounts thereon.

Factors in Trade Discount.—Trade discounts are influenced by a variety of causes, or factors, which may be divided roughly into two groups:

A. Chief Factors

Fluctuations in prices of raw materials, coal and iron.
Fluctuations in wages.
Cost of distribution.

B. Minor Factors

Supply and demand.
Competition in trade.
Risk in, and length of, credit.
The capital at disposal of manufacturer and buyer.
The magnitude of the requirements of the buyer.
Cost of carriage.

Debatable Points.—In dealing with the subject of trade discounts proper, one has to consider a number of debatable points both for and against the practise.

It is perfectly natural that the retailer, who has profitable commercial knowledge or advantages, should desire to keep it as much as possible from the gaze of the public, and will have no desire to let them know his methods, markets, advantages in prices, and consequent profits.

The daily papers give us the latest market prices of various commercial commodities, and sometimes the retailer is rather unpleasantly reminded of the fact that such and such goods are down; but how far do these quotations affect the ultimate purchaser or consumer? Practically, his benefit is nil, as he has little or no means of comparing values.

On the other hand, it may be argued that to let the public into the secret of the gross profits in any trade is

an injustice and injury to that class of traders; and this would be particularly and keenly felt by business people with working capital, such as a retailer whose working expenses are usually heavy when compared with his capital.

Discount a Compensation.—Large trade discounts are often given to compensate for heavy establishment expenses, and cost of distribution. Take, for instance, goods of a fragile nature, or goods great in bulk but light in weight; in both cases the carriage on these goods will be much higher than the goods occupying less space in transit, and on which the risk of breakage in transit and storing is much less.

Trade discounts represent merely the accustomed profits to the mind of the ordinary individual, purchaser or consumer, uninitiated in the subject of establishment expenses, such as interest on capital sunk in stock which he may be obliged to keep an indefinite period before he effects a sale, depreciation, competition, cost of distribution, such as advertising, rent, wages, carriage, and other incidental trade expenses.

There is something about trade discount that appeals to the mind of those unacquainted with its principles which suggests fabulous profits. For the present, the middleman's is the most favorable method of distribution, and this will only continue so long as he can make, or has a prospect of making, sufficient to compensate him for his risks and expenses of distribution, and replace the capital he has expended in addition to a living profit. As Adam Smith says: "Whatever part of his stock a man employs as capital, he always expects to be replaced to him with a profit." And again: "Dealers must in all ordinary cases have their reasonable profit, and where competition is free can seldom have more than that profit."

Manufacturer and Consumer.—Trading direct between manufacturer and consumer is at the present time a vexed question. It may pay a large consumer to buy

direct from the manufacturer, so long as his requirements are of considerable magnitude, and in some cases he buys equally as well as the middleman; but where his requirements are small, it will be much to his advantage to go to the retailer who stocks a manufacturer's goods, as he can select just what he requires; and even if he pays more than in direct trading, yet, had he sent his order direct, it would not, perhaps, have been worth the while of the manufacturer executing it, or otherwise the attendant expenses in delay in execution of the order, extra carriage and other risks, would increase the ultimate price paid to the manufacturer above what he would pay to the dealer.

Manufacturers and Retailers.—In the hands of the manufacturers and merchants, a trade discount is a very useful factor. As circumstances require the former to advance or reduce the value of their goods by advancing or reducing their discounts, they can readily do so without having to resort to the making out of new list prices, and the printing and issue of revised price lists. In some instances this would involve a great amount of time, labor and expense.

They are also useful in enabling a manufacturer or wholesale dealer to vary his net prices, as, for instance, it is generally conceded that a large buyer commands better terms than a small one, since it pays a manufacturer better to make a large quantity of one kind of goods than it does to make a small quantity of many kinds. He may get comparatively better prices for the latter, yet on the former his ultimate profits will probably be larger.

A trade discount affords a useful sliding scale between the manufacturer and retailer whereby they may advance or reduce their selling prices.

Trade discounts are an important item for consideration in all businesses in which work is estimated for, as in the case of a large contractor who undertakes the erection of some public building, and whose estimate not only includes brick and mortar, but every other item required for the completion of the building.

Neither a Profit nor a Loss.—In most cases a trade discount may be said to be neither a profit to the buyer nor a loss to the manufacturer, as it is the general custom, especially where large discounts are allowed, to deduct the trade discount agreed upon from the gross amount of each invoice, the trader generally basing his selling price on the net prices he pays to the manufacturer.

In the case of a rise or fall in discounts, the advance or reduction will affect the profit or loss to the extent of the goods the manufacturer may have on hand when the change takes place. But with the retailer the case is different. As his selling prices are fixed on the net prices he pays for the goods he sells, he can re-mark his goods to suit the fall or rise, and so avoid a loss, and can regulate his profits more easily.

Terms of Discount.—There is no hard and fast line with regard to the stating and fixing of terms. Some firms print them on their invoices, leaving blanks for filling in the discount, others stamp them on the statement, and in some cases the terms are printed on the invoice heads, somewhat as follows:

Prompt cash, 4 per cent.

End of month, $3\frac{1}{2}$ per cent.

End of following month, $2\frac{1}{2}$ per cent.

Again, two firms in the same town and in the same trade, manufacturing similar goods, often differ in price lists, and as a consequence in terms and discounts. While one will allow $7\frac{1}{2}$ per cent discount for prepayment with order, or 5 per cent for cash up to the 25th of the month following delivery, the other firm will allow 5 per cent only up to the 25th of the month after delivery, and no discount thereafter.

Principle of Trade Discount.—The principle of trade discounts is not only to afford the manufacturer a ready mode of adjusting his selling prices, but as it were to act as a buffer between him and the trader's customer, and to

protect the interest of the middleman against loss, and insure him a reasonable return for his outlay, and expenses in conducting his business.

Again, in the case of the manufacturer: he may make the same kind of goods in several different qualities of materials, and weights of those materials; yet for each he has but one gross price, and he, therefore, regulates his net price of the various qualities by quoting a different discount.

Trade Discount and Profits.—Trade discounts sometimes affect the profits of the factor or dealer in proportion as he is able to retain the discount he is allowed by the manufacturer, or the difference between the manufacturer's discount and the discount he may have to allow his customer. Nowadays, it is in some business transactions usual for the manufacturer or retailer to allow his customer a certain discount on the manufacturer's price list, and in the manipulation of a trade discount in this sense it may be a profit or a loss.

With the manufacturer the trade discount is no real loss, as it is a fictitious price put upon the costs of production, and these include profits on capital.

A trade discount may, however, be the rock on which a trader's profits may be wrecked and a loss sustained. Through error or carelessness in operating the discount between manufacturer or wholesaler and the consumer, the retailer may make a loss while he imagines he is making a profit, or he may suppose a given transaction leaves him a larger gain than it actually does.

The subject of gaining a given rate per cent ourselves while we allow another who buys from us a discount also, is a matter which is not as well understood as it might be, and many a trader has discovered on balancing up his affairs that his gross and estimated profits were widely different.

The Case of the Dealer.—It will be generally conceded that a merchant or dealer who keeps a large and varied stock of a certain manufacturer's goods, and who buys

in large quantities, is entitled to better terms and lower prices than the consumer who possibly only consumes as many dollars' worth annually as the other does thousands. To place them on an equality in point of price is a real injustice, and manifestly unfair to the dealer; nor is it equitable to try to do business with the trade and the public, on the same terms.

It may be justly held that a merchant or dealer is entitled to some consideration for his local knowledge, and for the attendant expenses and risks of keeping stock and giving credit, and for his representation of a variety of manufacturers. Granted there is no abstract right on the part of the middleman, old custom counts for something, and it is obvious that the dealer is able to render services for which he is entitled to some adequate remuneration. He is a buffer between the manufacturer and bad debts; and to sell to one hundred old-established and respectable merchants or traders is clearly less risky than dealing with one thousand persons of whom the manufacturer knows nothing at all.

Some Exceptions.—There are certain exceptions to the above argument: there are many large firms, making special goods, in which they can not be beaten, and possibly own a monopoly of the things they manufacture; and in the case of government, public works, or railway contracts, are invited to tender direct. These corporate bodies in most cases prefer to obtain their supplies direct, and save intermediate profits, and it is to the mutual advantage of both, credit being short and payments prompt.

In considering the question of trade discounts, we must remember that when a wholesale buyer is purchasing goods for stock, he will generally have a manufacturer's catalogue before him, with prices printed therein. It will be obvious, therefore, that a net list, or one subject to a small discount, will be a great convenience. But the catalogue has also to serve the purposes of the salesman when selling to a customer, and to him the discount is an important item, for be the prices never so low, the

customer will rarely pay any extra carriage or other expenses connected with getting special goods to order. To press the point may send the customer elsewhere in the hope of finding what he requires in stock, in order to save what he considers an extra charge.

The prices, therefore, should be subject to such a discount as will enable the retailer to profit by the transaction; profit in this case meaning something over and above working expenses and special charges incurred in getting goods to order.

Profit or Working Expenses.—Taking this view of the matter, unless a sufficient margin is provided for in quoting a trade discount, the retailer merely receives a contribution toward his working expenses instead of making a clear profit; and as a great amount of business is done in this manner at the present day, it is evident that an adequate allowance is required, otherwise the retailer's interests will suffer.

Manufacturers do not generally realize that the working expenses of a retail business are sometimes exceedingly heavy, especially where the annual returns are small in comparison to the capital outlay, and this to-day is more strikingly apparent than formerly, because goods are so much cheaper. The expenses of distribution of \$10,000 to-day are much heavier than they were twenty-five years ago, because the bulk is quite half as much more; and it will be obvious this means larger warehouses, more assistance, and other outlays. Besides the demands of the public are more exacting. Quick delivery of orders, perfection in style and quality, attractive show-rooms, expert assistants, special advertising—these are among the items involving more expense. The percentage borne by the working expenses to the turnover to-day must necessarily be higher than a few years ago. As a rule, the larger the business done, the smaller the percentage of expense will be.

Discount Must be Sufficient.—We have said that the discount should be sufficient to cover special expenses on

a cheap article; these are always heavy in proportion, and occasionally the same may be said of more expensive goods.

Take the case of a special lot of electrical fittings, which are to be fixed at a short notice, and to insure this several telegrams are required; the goods have to be forwarded by express, perhaps a hundred miles, and then delivered by wagon several miles more. In this case it will be obvious that the expenses may be fourfold; yet, probably a direct charge can not be made for these; but if the dealer avoids the low discount catalogues, the margin he has to work on will be sufficient to insure him an adequate return for his outlay.

There is another matter deserving attention. The merchant or retailer frequently has transactions in which another tradesman is concerned. Perhaps a builder brings one of his patrons to select certain goods at a hardware store, even though the goods may be debited to the former; and, unless the builder receives his percentage of the discount, his trade may be diverted into other channels.

Manufacturers who have been accustomed to sell at net prices take exception to lists subject to a large discount, on the ground that they involve greater possibilities of error, extra staff of clerks, and so forth; but this objection is a small matter, because net prices may be used in invoicing, and a price list, subject to discount, reserved for the retailer's purposes.

XXIV

REAL ESTATE

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XXIV

REAL ESTATE

I. DEFINITION AND CLASSIFICATION

THE term "real estate" is intimately connected with the more popular term of "property," and it is necessary to distinguish between the various kinds of property in order to discuss the subject as a whole. The law defines property as any object or thing in which one has the right of a proprietor or owner.

All property may be divided into two classes; viz., *Personal* and *Real*.

1. Personal Property.—Personal property may be here defined roughly as all those private or removable things which are not so closely attached to the land as to be considered a part of it. It includes all property rights not included under the head of real property. Under this head are included leasehold estates in land, liens upon land, and all interests in movables.

2. Real Property.—Real property, commonly called real estate, covers all those things which are immovable, such as land; and whatever is affixed to it, such as buildings; and whatever is issuing out of it. Real property again may be either *Corporeal*, that is the actual tangible land and its fixtures; or *Incorporeal*, an intangible right in the land which does not amount to the ownership of it, such as a right of way. It includes all estates in land except leaseholds and liens.

Legal Distinctions.—Differences affecting the transmission of real and personal property have been subject

to many modifications by statute. The following are the chief points of difference.

1. On the death of the owner leaving no will, real estate goes to the heirs, personal to the executor for payment of debts and distribution of the balance among the next of kin, who nowadays are often identical with the heirs. The question of what is personal and real is often disputed, even in cases where a will is left. For example, an owner left his personal estate to his son and his real estate to a third party. In the property were a number of leases running for 99 years, and it was held that these were personal property which went to the son.

2. More formality is required in the transference of real estate, than of personal.

3. The law of the place of location of real estate governs the rights in it. In personal estate, the law of the place of domicile of its owner prevails.

4. In general the laws dealing with personal estate are more liberal and less technical.

Estate in Land.—The estate is the interest which one has in land or real property. This interest may be absolute ownership or it may be only a temporary or conditional ownership. There may be different kinds of estate in the same piece of land. The land itself is permanent and unchanging, but one person may own it and have possession and enjoyment, while another who also has an interest in it has to wait for his possession and enjoyment till the termination of the first estate.

In the early days of the feudal system once existent in England, from which many of the terms and rules used in property law in the United States are taken, the absolute title to all real property was in the king, all others in the land being his tenants. Holding directly under the king were his nobles, to whom grants of land were often given, the requirement being that in war-time, the nobles should serve the king with so many trained soldiers. In order to get this body of soldiers, the nobles then parceled out the land among other tenants of various degrees, who agreed to give military service as part of their rent. The

estate of the tenant was called "fee" and from that was derived the first variety of estate in land.

Estate in Fee Simple.—The complete and absolute ownership of real property is called "Estate in Fee Simple." It endures for the life of the owner and descends to his heirs, collateral as well as lineal, provided he has not disposed of it. While in possession of it, the owner can use the land as he pleases, sell it, mortgage it, or grant privileges in connection with it as he wishes; so long as what he does shall not conflict with his neighbors' peace or enjoyment of their land. The land can not be taken from him without consent except for three reasons:

1. For payment of taxes.
2. By creditors for the satisfaction of debts.
3. Under the power of Eminent Domain, by which the State may, on the payment of reasonable compensation, take his land for public use, such as the laying of a railroad or highway. Powers to exercise this right are granted to corporations or private promoters engaged in works of public utility, as railroad companies, cable and telegraph companies, etc. This may be thought a high-handed treatment of private rights, at first view, but it must be remembered that one obdurate individual would otherwise be able to block any scheme of public advantage.

Life Estate.—The absolute owner of an estate may grant the use of his land to another for life, or for a period of years. If for life, then the estate so granted is called a life estate, and is limited by the duration of the holder's life. A life estate may be granted to a woman during her widowhood, terminable on her remarriage.

Rights of the Holder of a Life Estate.—The owner of a life estate, unless there is a restriction in his grant, may do any of the following things:

1. Dispose of his interest in the land, or grant a portion of it for certain number of years. But

no rights can be granted which do not terminate at his own death.

2. Cut timber on the land to be used for fuel, building fences and repairing buildings. Any other purpose is forbidden; even the sale of timber to pay for the labor of performing the above operations.
3. Work mines or gravel pits which have been previously operated, but not open new ones.

He may not do the following:

1. Recover anything for improvements, but he is bound to make ordinary repairs at his own expense.
2. Commit waste, by allowing or causing any injury, permanent or material, to the property; so that the next owner will have to commence his ownership by outlays in setting the property to rights.

Estate of Dower.—An “Estate of Dower” is the life interest which a wife owns in her husband’s real estate, to the extent of one-third; in some States, one-half; which is the provision made by the law for the support of a widow. It is required that the marriage be legal, and that the husband duly own the land some time after marriage. The wife has no vested interest until the death of her husband. If the husband sells the land without her consent, on his death she can claim her proportion from whoever is holding the land at that time. In buying land from a married man it is vital to include the name of his wife in the conveyance, so that she may release her right of dower. She, however, can not release it to her husband, or to any one but the person to whom the land is conveyed. This right does not prevail in all the States, the widow being sometimes given an absolute share.

Estate by Courtesy.—An “Estate by Courtesy” is an estate for life which a husband has in all the real estate of his wife at her death, provided a child was born of the marriage, the marriage being legal. The child must

have lived if only for a moment, its cry being held to be evidence of life. This estate has been done away with in some States by statute, and modified in others. In New York State it comes into operation only should the wife die without disposing of her real property.

Homestead Estate, or Right.—Statutes have been passed in many States creating a "homestead right." This consists in the right to enjoy a certain number of acres of land free from liability for debt, and therefore exempted from sale. The exemption is extended only to the head of a family (a husband and wife may constitute a family) on whom depends the support of those living with him. The exemption is acquired by occupancy of the place as a home, though in some States there must also be recorded a notice that the premises are claimed as a homestead. The amount exempted varies and is determined by area, or value, or by both, according to the State in which the property is located.

Estates held jointly in Common.—Any estate in land may be held or owned by one person in severalty, or by two or more concurrently or jointly. The two principal classes of estates held jointly are joint tenancies and tenancies in common. In the United States, all joint estates are presumed to be the latter, unless contrary intention is expressed. The characteristic feature of it is, that on the death of a tenant in common, his share goes to his heirs or devisees, and not as in joint tenancy to the survivors. The estate is terminated by partition.

Equitable Estates.—The estates mentioned before have been what are called "legal" estates. But it is possible to divide estates in land, so that while one person has the legal title, another has the equitable, and thus a trust is created. A trust in such property holdings is that obligation of the trustee, who is the legal owner, to hold the property for, and account for, its profits to another, the beneficiary or equitable owner.

A charitable trust may be created for the public or a

section of the people, which can be enforced by an officer of the State.

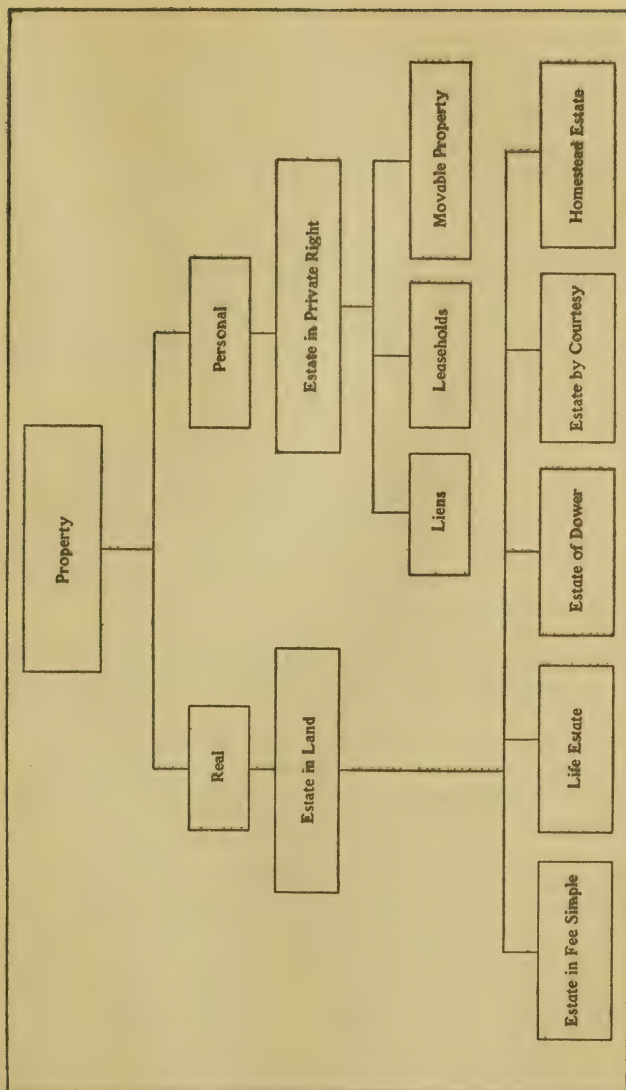
2. RIGHTS AND RESTRICTIONS IN LAND

The owner of a tract of land has more rights in such ownership than are apparent. He owns the surface of this tract, and he also owns the space below it, as far down as he chooses to go, to the center of the earth, if that were possible. He owns the air above it, often a valuable consideration, as in case of a health resort. The trees growing on it, and everything else fixed to it, are his. If there are minerals below the surface, including mineral oils and gases, they are his to do with as he pleases subject to any rights reserved by the State. Should he discover gold and silver they are his. If the lands have been public domain, then a mining claim may be established in them, and Congress has provided legislation for that purpose.

Mining Regulations.—Three of the mining regulations are as follows:

1. A lode or vein, that is, a line of metal embedded in quartz or rock, may be located to the extent of 1,500 feet in the direction of its course, and 300 feet on each side.
2. A placer, that is, ground containing mineral in earth, gravel or sand in a loose state, may be located by one person to the extent of 20 acres; or if eight persons work it in combination, then to the extent of 160 acres.
3. Any one who locates a claim, must do at least \$100 worth of work on it annually or forfeit his claim.

Waters.—Standing water, such as a lake, belongs to the owner of the land under or around it, and he has the exclusive right of sailing on and fishing in it. If two or more owners have lands bordering on the lake, then the rights of each extend to a central point in the lake.



CLASSIFICATION OF PROPERTY

If the lands run along the bank of a stream, ownership usually extends to the middle of the stream. If, however, the stream is of such a size as to be navigable, there is no such right, the title to the soil underneath being held by most authorities to belong to the State. In the case of navigable lakes, ownership is also in the State.

Ice.—Ice belongs to the owner of the land over which it forms, except when over navigable waters, when the first comer may remove it. For instance, it was held that the owner of the bank along the Kansas River, a navigable river, did not own to the center of the stream, neither did he own the ice formed on the stream adjacent to his land, unless he was the first to take possession of it.

Products of the Land.—*Natural:* Those natural products, such as trees, grasses, bushes, etc., which grow without cultivation and the labor of man, are parts of the land, and go with it. Fruit upon trees or bushes has usually been included, though cultivation may render it outside the scope of this rule.

Industrial: If the products are growing crops, the result of manual labor and fertilization, it is held that even though attached to the land they are personal property, and do not go with the land. A person who has a lease of uncertain duration, which comes to an end before the crops he has planted have ripened, has the right of cultivating and gathering them. If the period of holding is fixed, he can not do anything after its expiration.

Fixtures.—Any article which has once been loose, but which has become actually or constructively fixed to the land, is a fixture, and has come to be regarded as going with or belonging to the land. In some cases, however, it is difficult to decide whether the article so annexed has become a fixture, or whether it is still personal property. At first, the early common law supported the claims of the landowner to everything attached to the land, but now there is an inclination to favor the tenant who claims

as his fixtures which he has erected for use in his trade or business. The question arises in all sorts of cases, between seller and buyer of land, between one mortgaging his land and the person granting him the loan, between the heir of a landowner and his executor, between a person who holds a mortgage on the real estate and one who holds a mortgage on the personal estate of the same person. If a farm owner wishes to sell his farms, he has to know what he must leave and what he can take away with him. A city tenant giving up a possession naturally wants to know what he will be called upon to leave in the way of utilities and decorations which he has put in at his own expense.

Some General Rules.—The following rules have come to be generally recognized in such cases:

1. Physical Attachment.—The fixture must be physically attached to the land or to some structure or thing which is itself annexed. This rule is subject to the following exceptions:

(a) A movable piece of a machine, itself a fixture, which if removed would render the main machine useless; or something absolutely requisite to a fixture, as for instance the keys of a house; these are regarded as fixtures.

(b) Anything of such weight as to remain fixed by gravity without the use of any attachments such as bolts, screws, etc., is called a fixture. An example of this was a statue weighing three tons, which stood on a base three feet high. This base rested on a foundation built of mortar and stone. Neither statue nor base was secured to the foundation in any way but that of its own weight. In an action which afterward arose, it was held that the statue was part of the land, since it was as firmly attached as if by artificial means.

(c) Heavy machinery may be considered as fixtures, though this is disputed in cases into which other considerations enter, such as the purpose of the person putting it in. If the article has been devoted to a purpose which

when carried out would make it a fixture, then it is held to be a fixture; as, for instance, fence rails laid alongside of a fence begun but not finished; or if part of the fence has been temporarily removed, then that part is still attached to the land.

2. Use of the Fixtures.—If an article is so firmly fixed that to remove it would destroy the article, or injure whatever it is attached to, then it is a fixture and is not to be removed. Gas or water pipes running beneath floors, or up behind walls, are so attached that they can not be removed without tearing out floors or plastering. If, however, gas fixtures, chandeliers, and water faucets are merely screwed in through holes in the wall or floor by a tenant, they may be removed on leaving. A tenant who puts in stoves or furnaces can remove them as furniture. A portable hot furnace, resting by its own weight on the ground, though connected with the pipes and registers, was held not to be a fixture. Looms in a woolen factory, attached to the floor by screws which could be removed without injury to the floor or looms, were also held to be personal property, and consequently did not pass with the building.

In another case, however (*Ottumwa Mill Co. vs. Hawley*, 44 Iowa 57), it was held that the machinery of a woolen mill was unremovable. The looms were affixed to the floor by screws, and the spinning jacks by cleats nailed to the floor, while the heavy carders were kept in position by their own weight. The question was raised by a purchaser under a mortgage, and the court gave a decision in his favor based on the satisfaction of the following three tests: The fixture was (1) actually annexed to the land or something attached to it; it was (2) applied to the use or purpose to which the mill, or that part of the realty to which it was attached, was appropriated; it was (3) evidently intended as a permanent accession to the estate.

These three tests may be employed in other cases to advantage. As an instance of point number 2, it has been held that hop poles taken down and stored away till

the next season are fixtures, as being appropriated and necessary to the cultivation of hops on the land.

3. Relation to the Property.—Whether the article is a fixture, or not, often depends upon the relation to the property of the person who attached or annexed it.

If the person who did so is the owner in fee, and the presence of the article is intended or likely to improve the land, it is held to be a fixture, and in the event of sale or mortgage, the article goes with the land. In the event of death, it goes to the heir and not to the executor. The owner may, however, at any time during life disconnect the article, or he may reserve it especially in case of sale or mortgage, or declare in his will that it is personalty. The presumption is always strong that improvements by a vendor or mortgagor are intended to be permanent. If the person is a tenant, there is strong presumption that he does not intend the improvement to be a permanent addition to the real estate, and he is therefore allowed greater license in the removal of fittings.

Trade fixtures, such as counters, shelving, and other store furniture, are removable; also chairs, etc., placed in a theater by a lessee. A farm tenant holding from year to year was allowed to remove a cider mill erected on the farm at his own expense. Wooden buildings resting by their own weight on flat stones laid on the surface of the ground, the only foundation, were held to be removable. A bowling alley erected on blocks was not considered a fixture.

A tenant may provide in his lease that he be allowed to erect buildings for manufacturing purposes, and remove them any time within the running of his lease. A tenant built, on those conditions, a brick engine-house on a solid foundation of masonry, and erected an engine firmly built into it. It was held that he was entitled to remove house and engine. He was instructed, however, to remove such fixtures within the time limit of his lease, failing to do so making him afterward unable to enter the premises and claim them.

Rights of Adjoining Owners.—*Fences:* The owner of crops is as a rule not bound to protect them by the erection of fences, but his neighbor owning cattle is required by common law to fence or pen his cattle. Local authorities, however, usually arrange and regulate this question, though in many States neighbors are required to maintain a fence between their lands, sharing the cost of erection and maintenance. Railroad companies are compelled to fence in their tracks, where possible or necessary.

Trees: A tree growing on the boundary line between the lands of two owners is owned by them in common, and neither may do anything to his half such as to affect the health of the tree. Either owner may cut branches on his side, if such will not injure the trunk, but he is not allowed to cut down or remove the trunk. If the tree is in one owner's land and has branches projecting over the boundary line into a neighbor's land, the neighbor may lop the branches at the exact point of crossing the boundary line, but he may not retain the branches or fruit, and must restore them to the owner or inform him that they are at his disposal. In so doing, the fact should be made clear that there is no attempt to deprive others of property, but merely to exercise one's own unquestionable rights.

Support of Land.—A landowner can not dig so near the boundaries of his neighbor as to disturb the lateral support of his land, and cause it to cave in.

Air: An owner may not pollute the air with smoke, dust, or odors, to such an extent as to prove an annoyance to his neighbors. If he continues, the neighbor may enjoin him or claim damages. Noise and the use of any machine causing vibration of the ground are also forbidden.

Water: One owner is not permitted to dam up, divert, or pollute water passing through his land to another's.

Easements.—An easement is the right that one owner may exercise over the property of another, which is acquired by grant, or by prescription—that is, by possession

and enjoyment for a specified period, usually of twenty years.

A lot is often sold on the understanding that the seller will not build on the next lot nearer the boundary line than a certain distance. This gives the buyer an easement to that extent in the light and air from the next lot. If the lot is sold with the covenant that the buyer shall not build within a given number of feet from the street, then an easement is created in favor of the seller.

A right of way—a familiar form of easement—may be acquired either by grant or prescription. If one sells land separated from the highway by the rest of one's land, then the buyer has a right of way across it to the land which he has bought.

Among other easements are the right of using a party wall; compelling one's neighbors to maintain a dividing fence; or the right of access to water, and its use.

If a highway passes over one's land for the general use of the public, he can forbid the cutting of trees or grass by its side, or its use for other purposes than that of a means of passage.

Building Laws and Regulations.—Not so long ago the man who wanted to build might erect any kind of an edifice that he wished. It was his house and he was free to do with it as he cared. If he liked to build it without windows, nobody cared much, and he could gratify any other insanitary eccentricities to the greatest possible extent. As cities grew and population became more and more condensed into small areas, the freak builder began to be a public danger. The rooms without windows harbored and bred disease. The inefficient plumbing killed off neighbors. The wooden building was a fire danger and overcrowding was a social and hygienic disorder. Therefore legislation stepped in, and to-day owners are more restricted in the use of their property than in times past. The police power of the State is exercised in many ways, sometimes perhaps irksome and apparently unreasonable. The owner of the land can not build thereon what he may desire to, and after buildings

are erected their use and occupation are restricted to certain purposes by the State. But while we are taxed more and have less freedom of use of property the value in money is greater.

The tendency in building is to erect structures of large ground area as well as of increased height. This applies not only to office buildings and loft buildings but apartment houses and hotels. The use of wooden beams in construction is largely done away with, and it will probably not be many years before the building of non-fireproof structures will be prohibited in all large cities. The enormous waste of life and property by fire is a disgrace to every progressive community.

The following are the chief requirements of the New York Building Code:

Permits.—Before the erection or alteration of any building or structure, or the construction or alteration of plumbing or drainage, drawings and detailed statements have to be filed with the Bureau of Buildings, and the approval of the Superintendent obtained, together with an affidavit, giving the name of the owner, and the person authorized to obtain the permit. In the case of a tenement house, a permit must be secured from the Tenement House Department, before application to the Bureau of Buildings. Ordinary repairs may be made without notice.

Definitions.—The following definitions of buildings are recognized:

Frame Buildings are those with exterior walls constructed of wood, irrespective of covering thereof.

Hotels are structures for sheltering residents or guests, having a general dining-room or café and more than fifteen sleeping rooms above the first floor.

Lodging Houses are buildings where persons are harbored for a single night or less than a week.

Office Buildings are divided into rooms for business purposes, with no part used for living purposes other than by the janitor and his family.

Private Dwellings are buildings intended for the occupancy of not more than two families, with not more than fifteen sleeping rooms for boarders.

Tenement Houses are structures intended for the occupancy of three or more families, living independently of each other and doing their cooking on the premises. Higher grade tenement houses are now popularly known as apartment houses, but the courts have not recognized a distinction of terms.

Areas.—Buildings may occupy the following areas of the lot upon which they stand.

Hotels: Five stories high, corner lot, area above first story, 95%; five stories high, inside lot, area above first story, 90%; for each story over five deduct 2½%.

Lodging Houses: Vary considerably according to style of building, but usually occupy about 60% of lot.

Office Buildings: Inside lot, at second story, 90%; corner lot, no restrictions; other business buildings, no restrictions.

Tenement Houses: Corner lot, 90%; inside lot, 70%, depending upon character of building.

REAL ESTATE MEASUREMENTS IN GENERAL USE

7.92 inches	make.....	1 link
25 links	}	" 1 rod
or		
16.50 feet	}	" 1 chain
4 rods		
10 chains	}	" 1 furlong
8 furlongs		
or	}	" 1 mile
320 rods		

10 sq. chains	}	make 1 acre
or		
160 sq. rods		

640 acres make 1 sq. mile

Gunter's chain = 22 yds. of 100 links

A section = 640 acres

A township = 36 sections, each 1 sq. mile

A sq. acre = 208 7-10 feet on each side.

CONTENTS OF FIELD AND LOTS

220x198	ft. = 1 acre
440x 99	" = "
110x396	" = "
60x726	" = "
120x363	" = "
240x181½	" = "

200x108	9-10 ft. = ½ acre
150x145	2-10 " = "

Excavations.—A depth of ten feet below curb is the average excavation. If foundations of a new building are carried beyond this point, the person causing such excavation to be made must support adjoining walls irrespective of the depth of same. If foundations are not carried beyond ten feet, the owners of adjoining properties must protect their own walls. If retaining walls are necessary on account of an excavation, they must be built by the person causing the excavation to be made.

By failure to give permission to an adjoining owner to carry out these provisions, risk is assumed by the owner refusing such permission.

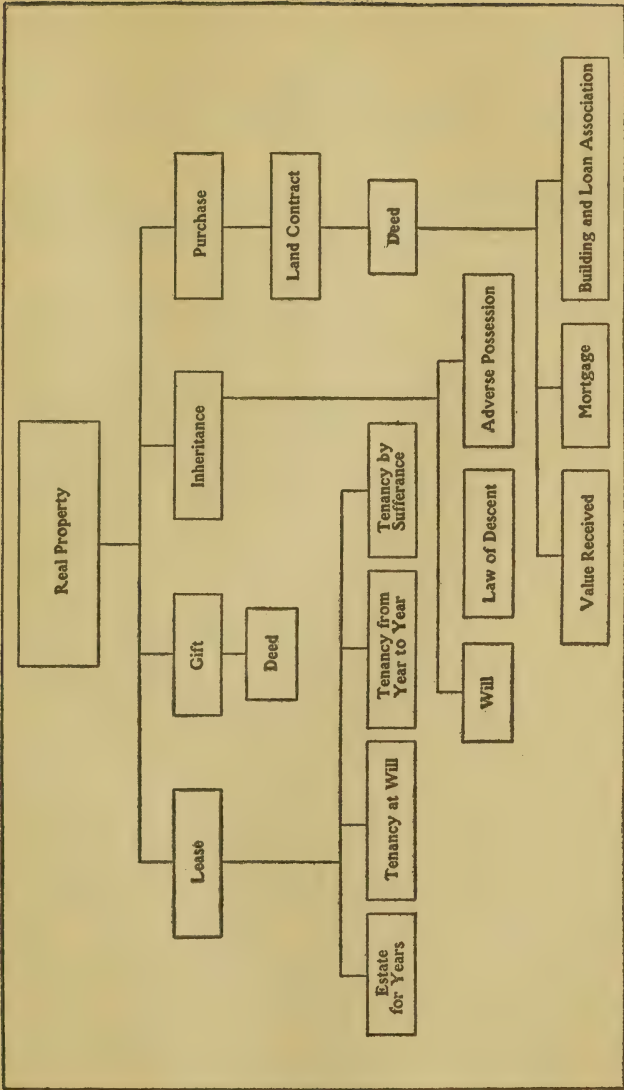
Limitation of Height.—Height is defined as follows:

For flat roof: From curve level at center of façade to highest point of beams.

For pitched roofs: From curb level at center of façade to average height of gable.

Of Non-Fireproof Construction: Hotels, 36 feet, 6 inches; Office Buildings, Private Dwellings, Restaurants, Stables, Stores, Studios, Tenements, Warehouses, and Factories, 75 feet each.

Of Fireproof Construction.—There are no limitations as to the height of buildings of fireproof construction, but when buildings exceed 150 feet, no inflammable wood is allowed for trim or floors. By Tenement House Act, a house can not be erected higher than one and a half times the width of the widest street upon which it faces.



OCCUPANCY OF REAL ESTATE

Fire-escapes are required on the following buildings: asylums; boarding-houses with more than fifteen sleeping rooms above basement; factories, hospitals, and hotels over three stories high; office buildings five stories and over; schools, and places of public assembly.

Unsafe Buildings.—When property is reported as unsafe, if an emergency arises, the Superintendent of Buildings has power to protect the same and to charge the amount expended against the property.

3. SALES AND CONVEYANCES

The title to real property, or the right of the owner eventually to obtain possession of it, may be acquired and held in several ways. It is the evidence which the holder of a property has as to his right of possession, and may be acquired: (1) by descent or (2) by purchase.

1. Title by Descent.—The title by descent is obtained (a) by will, (b) by the law of descent, and (c) by adverse possession.

(a) *By will.*—Property may be transferred by will, but should the person to whom the transference is to be made die before the testator, the bequest lapses, unless, according to the statutes of some States, provision has been made as to the one who should then take it. Otherwise the bequest will go to the testator's heirs, unless there is a residuary clause, or one as to the disposal of the rest of the property, when it will go to the person designated in it. It may be emphasized in this connection, that as the law of wills is so much a matter of statute, no one should think of making an elaborate will disposing of property without legal aid.

(b) *By law of descent.*—If an owner of real property dies leaving no will, the real estate passes to his heirs, subject to any rights possessed by husband or wife, such as the estate by courtesy or of dower described in the preceding section. The statutes determine who shall be heirs. The following is the usual order:

(1) The children, or children of a deceased child, divide their parents' share. Failing whom,

(2) The father. Failing whom,

(3) The mother, brothers, and sisters, and children or descendants of deceased brothers and sisters. Failing whom,

(4) Collateral relatives, as uncles and aunts on the father's side, and their descendants, and so on.

(c) *By adverse possession*.—Mere occupancy by the present owner under claim of title, in certain circumstances if not interrupted during a certain number of years, will give the occupant permanent title. Thus title by adverse possession is an open, exclusive and uninterrupted possession of property, hostile to the real owner, for a period usually of twenty years. If twenty years pass without claim being made by the real owner, then any claim is barred by statute. Adverse possession can be shown by residing on, cultivating, or fencing the land.

2. Title by Purchase.—Under the term "purchase" is included all other means of acquiring title to land, by gift, or for consideration.

This is the common method of obtaining property and the procedure is practically the same in every State of the Union. The first step in the transaction, where there is a money consideration, is the drawing up of a contract.

Land Contract.—When a title to land is acquired by purchase, an agreement is usually entered into, wherein one party agrees to purchase from another the property upon the terms prescribed, and the owner agrees to sell and convey the property for the agreed-upon consideration. This agreement, which must be in writing, is known as a "Land Contract." It does not affect conveyance of the title, however, and is only a temporary instrument drawn up to bind the sale and allow search of records to be made, or to permit collection or raising of the consideration, or payment of so much by instalment. A specimen land contract is shown herewith.

[Specimen Land Contract]

ARTICLES OF AGREEMENT. Made this.....first..... day of October in the year One thousand nine hundred and ten BETWEEN.....*Joseph Swift*.....of the city of Binghamton, County of Broome, State of New York,..... of the first part, and.....*Frederick Lewis*.....of the city of Syracuse, County of Onondaga, State of New York,.....of the second part, in the manner following: The said parties have and hereby do mutually covenant and agree as follows: The *part y* of the first part to sell, and the *part y* of the second part to purchase, ALL THAT TRACT OR PARCEL OF LAND, situate in the city of Binghamton, County of Broome, and State of New York, briefly described as follows:

Beginning at a point two hundred (200) feet east of the northeasterly corner of Main Street and Oak Street, on the northerly line of Oak Street, and running thence northerly and parallel with Main Street one hundred and seventy-five (175) feet; thence easterly and parallel with Oak Street forty-five (45) feet; thence southerly and parallel with Main Street one hundred and seventy-five (175) feet; thence westerly along the northerly line of Oak Street to the place of beginning,.....for the sum of ten thousand.....dollars (\$10,000.00....), which sum the said *part y* of the second part hereby agree s to pay to the *part y* of the first part as follows: five thousand dollars (\$5,000.00) on the first day of November, 1910, and five thousand (\$5,000.00) on the first day of January, 1911..... Said *part y* of the second part also agree s to pay ALL taxes and assessments which shall be taxed or assessed upon said premises from the date hereof until the said sum shall be fully paid.

And the said *part y* of the first part, on receiving such payment at the time and in the manner above mentioned, shall, at*his*..... own proper cost and expense, execute and deliver to the said *part y* of the second part, or to.....*his*.....assigns, a warranty deed, for the conveying and assuring to *him*, or them, the fee simple of the said premises.....

It is agreed that the *part y* of the second part shall have possession of said premises after the first day of November, 1910.

And it is agreed that the stipulations aforesaid are to apply to and bind the heirs, executors, administrators and assigns of the respective parties.

IN WITNESS WHEREOF, The said parties have hereunto set their hands and seals the day and year first above written.

In Presence of
JOHN COOKE

JOSEPH SWIFT
FREDERICK LEWIS
(Seal)

Liens on Real Estate.—Before purchasing land one should always be careful to have the records searched, in order to find out whether the vendor's title is good and whether liens of any description are recorded against the property.

A lien is any claim which can be levied on the property for satisfaction of debt. Among those who have liens are:

(1) Those who obtain them by statute; in some States, unpaid mechanics who have done work on the buildings, or those who have supplied material for it.

(2) In some States, a seller of land who has not been paid. This is a lien for the purchase price.

(3) One who occupies lands believing them to be his, and makes betterments, but who is afterward ejected by some one having a better title. This constitutes a lien for the betterments.

(4) The State, for taxes.

Also a judgment against a person, taken in a federal court, is a lien on all the lands of the debtor situated in the State in which judgment is rendered. A judgment in a State court is a lien on all the lands of the debtor situated in any county of that State.

Searching the Records.—In the passing of title to real property, it is usual for the buyer or grantee to reassure himself that the title of the seller or grantor is in order and clear of all claims of a third party or parties. To find this out, the records of the public office containing all such deeds, mortgages, etc., are searched either by a lawyer or professional searcher. The result of the search, if any, is extended as an abstract of title, and shows all transactions which have taken place in regard to this particular piece of property. Any mortgages or loans upon the property would be disclosed, and anything prejudicial to the future enjoyment and possession of the land. In recent years title insurance companies have formed, which not only search a title, but guarantee it. This feature will be found considered elsewhere in the present chapter.

Deeds.—The conveyance of the title may be absolute, in which case it is made by deed. If conditional then it is made by mortgage. In the law of real property, a deed may be defined as a written contract signed, sealed and delivered by which one owning land conveys it to another. The two forms in common use are "warranty" deeds and "quit-claim" deeds. The warranty deed conveys the title and contains certain covenants or warrants, while the quit-claim conveys the title, but throws upon the grantee or buyer any risk as to good or bad title. A specimen warranty deed is here shown.

[*Specimen Warranty Deed*]

THIS INDENTURE

Made the.....first.....day.....of.....June.....
in the year, One thousand nine hundred and ten.....

BETWEEN..... *John Bailey*.....
..... of the City of Buffalo, County of Erie, and
State of New York,.....of the
first part, and.....*Charles Merritt*
.....of the same place
.....of the second part.

WITNESSETH, That the said *part y* of the first part, in consideration of the sum of four thousand dollars.....
(\$4,000.00....), lawful money of the United States, paid by the
part y of the second part, *do* es hereby grant and release unto
the said *part y* of the second part.....*his*.....heirs and
assigns forever.

ALL THAT TRACT OR PARCEL OF LAND, situate in
the..... city..... of..... Buffalo..... County
of.....Erie.....and State of New York, situate, lying
and being in the tenth ward of the City of Buffalo, and known
as lot numbered three hundred and thirty (330) on a "Map of
Land in the city of Buffalo lying between Tenth and Twentieth
Streets" and filed in the County Clerk's office of Erie County
on the fifth day of June, 1908, bounded and described as follows,
viz.: Commencing on the northwesterly corner of First Avenue
and Thirteenth Street and running thence northerly along the
westerly side of First Avenue forty-three (43) feet, thence west-
erly and parallel with Thirteenth Street eighty (80) feet, thence
southerly and parallel with First Avenue forty-three (43) feet
to the northerly side of Thirteenth Street, and thence easterly
along the northerly side of Thirteenth Street eighty (80) feet
to the place of beginning.....

TOGETHER with the appurtenances, and all the estate and rights of the said *part y* of the first part in and to said premises. TO HAVE AND TO HOLD the above granted premises unto the said *part y* of the second part.....his.....heirs and assigns forever.

AND the said *John Bailey, part y* of the first part,.....do es covenant with the said *part y* of the second part as follows:

FIRST.—that the *part y* of the first part.....is.....seized of the said premises in fee simple, and *ha s* good right to convey the same.

SECOND.—That the *part y* of the second part shall quietly enjoy the said premises.

THIRD.—That the said premises are free from incumbrances.

FOURTH.—That the *part y* of the first part will execute or procure any further necessary assurance of the title of said premises.

FIFTH.—That the said *John Bailey, part y* of the first part.....WILL forever warrant the title to said premises.

IN WITNESS WHEREOF, The said *part y* of the first part *ha s* hereunto set.....*his*.....*hand* and *seal* the day and year first above written.

In Presence of

GEORGE EDWARDS

JOHN BAILEY (Seal)

STATE OF NEW YORK, }
County of.....Erie..... } ss.
City of Buffalo..... }

On this.....first.....day of.....June.....in the year One thousand nine hundred and ten.....before me, the subscriber, personally appeared.....*John Bailey*.....to me personally known to be the same *person* described in and who executed the foregoing instrument, and *he*.....acknowledged to me that *he* executed the same.

(Notary's Seal)

HENRY A. DAVIDSON,
Notary Public for Erie County, New York.

To constitute a valid conveyance of property, the deed must be in writing or printing. It must also contain the following features:

- (1) Parties capable of contract.
- (2) Property to be conveyed.

- (3) Words of conveyance.
- (4) Description of the property.
- (5) Signature and seal of grantor.
- (6) Delivery and acceptance.
- (7) Acknowledgment before a notary, or other authorized official, or in some States, before witnesses.
- (8) In some States, registration.

A quit-claim deed would read like the above except that it would say "does hereby remise, release, and quit-claim unto the second party," and would omit the warranties. A deed may be a gift, that is, the grantee may pay nothing. In such case it is usual to say "in consideration of one dollar to me in hand paid, and other good and sufficient consideration."

Clauses of the Deed.—The clauses of a deed may be summarized as follows:

1. The premises. 2. The habendum. 3. The redendum. 4. The covenants or warranties. 5. The conclusion. 6. The acknowledgment.

1. *The premises* begin with the date, followed by description of the parties. Then comes the consideration paid. The words of conveyance are usually: "Do hereby grant, sell, and convey," or "grant and release," followed by the words defining the estate as "unto the said party of the second part, his heirs and assigns forever." If the word "heir" is omitted, and the grant was to the grantee only, by common law only a life interest would be conveyed. In some States, however, any display of intent to grant a fee will be interpreted as such.

The description of the property by references to maps, boundaries, or any natural object of note must be exact enough to be identified.

2. *The habendum* usually reads: "To have and to hold, the above grantor promises unto the said party of the second part," followed by the words defining the estate granted, whether for life, or for years in fee simple.

3. *The redendum* contains any rights or interests reserved by the grantor, such as the use of a path or well,

or the right to mine coal or minerals; but whatever it is such right must be particularly described.

4. *The covenants, or warranties.*—A deed may be a simple warranty deed containing only the covenant that quiet enjoyment is assured, and that the title of the grantor is warranted; breach of which renders the grantor liable to damages. The deed may, however, have all five elements, which usually read as follows:

First: "That the party of the first part is seized of said premises (in fee simple) and has good right to convey the same."

The grantor must have the estate as described to the full amount, and be the sole owner or person entitled to convey.

Second: "That the party of the second part shall quietly enjoy the said premises."

Possession is warranted free from any claim, eviction, or legal action by the grantor, his heirs or assigns.

Third: "That the said premises are free from encumbrances."

The grantor warrants that no third party has any outstanding rights in the property, such as mortgages, easements, no probability of sale for unpaid taxes, no unexpired judgments.

Fourth: "That the party of the first part will execute or procure any further necessary assurance of the title of said premises."

By this the grantor agrees to perform any further acts which may be needed to make the grantee's title more secure, such as the execution of further necessary documents, as the release of a mortgage.

Fifth: "That the said party of the first part will forever warrant the title to the said premises."

The grantor in this gives assurance that the grantee shall never be evicted in any way from the premises, by reason of a superior title to such premises being owned by another.

5. *The conclusion* contains the statement that the grantor has signed and sealed, followed by his signature and seal, and the names of the witnesses, if any. The re-

quirement as to a seal has been abolished in many States.

6. *Acknowledgment*.—It is usual for the grantor to acknowledge his signature before a notary public, stating that the deed is genuine and of his own volition. The notary then adds his statement or certificate to that effect, and signs and seals it. The reason for this is that in many States, without this certificate, recording is not allowed. While in others, it is necessary to the deed as proving its validity.

The Quit-Claim Deed gives the grantee but small assurance of the integrity and continuance of his title. It contains none of the warrants of the warranty deed, and merely conveys what interest, if any, the grantor has. The words of conveyance are somewhat different, and may be as follows: "Do hereby remise, release, and quit-claim unto the second party." This form of deed may be used by one of two joint owners, or several heirs, who wishes to convey his or their shares to the other or to another heir; or where the owner of an easement or similar estate in land wishes to free the holder of the fee by transferring it to him.

Delivery and Acceptance of the Deed.—The deed must be delivered by the grantor to the grantee, but it must be a voluntary act, and if taken in any other way without his consent, as by theft, it is not delivery. Usually it is a manual delivery, but where intention to deliver is apparent, less than this has been held to denote delivery. A "delivery in escrow" is a delivery of the deed to a third person, such as an attorney or agent duly authorized to hold it until some condition is performed or satisfied. The grantor, however, having once let the deed go out of his hands can not recall it. The grantee is required to accept, by recording the deed, though sometimes the fact of the grantee having possession is proof.

Recording the Deed.—Historically the earliest method of transferring ownership of land from one person to

another was not by any written instrument but by some open act, upon or connected with the land. It was customary for the buyer and seller to visit the place, and publicly acknowledge that the buyer had become the owner of the property. Sometimes some symbolical act would be performed, a twig broken, or a piece of stone from the ground handed to the buyer by the seller.

Transactions of that sort rested merely in the memory of living persons, and the fact that there had been such transaction might easily be forgotten. There would be disputes of fact between the persons interested, and much resulting confusion, so that in modern times it became necessary and customary to produce evidence of the transfer of land by a permanent deed bearing testimony in writing to the fact that such a transfer had been made, or by an open acknowledgment before an official of a court, and a record of such acknowledgment made upon the records of the court. From this desire and necessity was evolved the present method of public record.

The States of this country provide by statute for the recording of all deeds and other instruments dealing with property, in some public office. The writings so recorded are notice to third persons that they exist, and can be examined by all who wish, so that no one can plead ignorance thereafter. Instruments relating to the same property have priority over each other in their order of recording. As has been mentioned, the records are searched for flaws in titles or encumbrances.

Registering Land Titles.—In New York State a law was passed, February 1, 1909, providing for the registration of titles in land. But for several reasons this law has not been popular. In the first place, existence of the law was not generally known, and its provisions were not understood. After it went into effect some property owners who investigated it were willing to have their titles registered, realizing that the existing system of titles was cumbrous, involved, uncertain, and expensive; and that any system claiming to make titles more secure and to simplify the methods of conveyancing would be a

distinct advantage. Second, those who sought information from the advocates of title registration were advised that it would be embarrassing to a future conveyance to have their titles registered, until certain conditions were made clear.

Most properties are mortgaged, and no title can be registered if the mortgagee makes objections. Even if the latter assents to the registration, there would be great difficulty in securing subsequent mortgages until the title insurance companies and lawyers change their attitude of doubt and hostility. In the event of offering the property for sale, the difficulty would be equally great in finding a purchaser, until the prejudices of the investing public were removed, and they were intelligently informed on the subject.

The Supreme Courts of Massachusetts, Illinois, Minnesota, Oregon, Colorado, and California, among other States, have passed favorably on the constitutionality of this law. It is true that the law has some minor defects, but there does not appear to be any perfect law, after thousands of years of legislation. These defects can be readily amended and corrected as soon as the occasion requires it.

Simplicity the Keynote.—The keynote of title registration is simplicity. The system is based on the principle that once a title has been proved clear beyond question, it should be so registered, and subsequent transaction need only be governed by the last record of registration. It aims to do away with delay, uncertainty, and expense of the present conveyancing system, to grant to the owner absolute title free from the possibility to attack, and to provide compensation for those who, through any error, were deprived of rights in the registered property. Millions of titles have been registered in Europe, Australia, and various portions of the American continent, and the errors have been almost infinitesimal.

Title Insurance.—Mention has already been made of the title insurance companies which now both search and

insure titles. Their advantages over the personal lawyer methods are obvious. They have perfect facilities for the elaborate search of records, and several persons instead of one to check up items against the possibility of error. Furthermore, they stand ready, by means of well-capitalized companies, to defend the purchaser's title against further claims. He can purchase property knowing that he will be absolutely protected in the enjoyment of it.

The same end is sought by the land registration law, and there seems to be no adequate reason why the title companies should not welcome and cooperate with it. When title insurance was a new idea, about a quarter of a century ago, it met with unfriendly reception. But three applications for title policies were received during the first year. At the end of the second year barely one hundred policies had been issued. The enormous growth of title insurance has taken place within the past ten years. Similarly, title registration will not make much headway until a strong company is formed to register titles and be prepared to meet all its demands for mortgage money, placing the advantages of the law within reach of all.

Four General Guaranties.—The title policy contains four general guaranties:

1. That the title is marketable. That is, if sold the purchasee can be compelled to fulfil his contract, or if the courts relieve him the company will stand the loss.
2. That the title is in the exact condition stated, showing the liens if any on the property and any other encumbrances.
3. That costs of any litigation affecting the property will be paid.
4. That if the property is sold with warranties, the assured suffer no damage, if defects in the title should be disclosed, for which he would otherwise be liable on these warranties.

Only a single premium is paid, and the policy is not

assignable. A contract of sale should follow the description in the policy, and be subject to the encumbrances and defects, if any, set out in the policy. If not, the company may deny liability if the purchaser breaks the contract of sale, and refuse to enforce it.

4. MORTGAGES

The best known and most usual method of raising or borrowing money on the strength of one's estate in land is that furnished by the mortgage. The mortgage is in form a conveyance of the title to land as security for a debt or other obligation, containing a defeasance clause stating that upon the payment of the debt or fulfilment of the obligation, the conveyance shall be null and of no effect. It is a contract and requires competent parties, a consideration, material consent, etc., and is executed, acknowledged and recorded like a deed. The party conveying the real estate, or the debtor, is called the mortgagor, and the lender or creditor is the mortgagee.

What may be Mortgaged.—Any interest in real estate which can be sold or transferred can also be mortgaged. Thus the owner of an estate in fee simple may mortgage it. A widow may mortgage her right of dower, or a mortgagee may mortgage his mortgage, or an heir may mortgage his interest.

Equity of Redemption.—Under the common law, a mortgage was an absolute conveyance, in which the mortgagor was entitled to receive a reconveyance of the property upon payment of the debt or performance of the stipulated conditions. The mortgagee held the legal title to the property, and upon the failure of the mortgagor to pay, he entered into absolute possession. This often gave rise to cases of hardship and injustice, as for instance, where a man wished to borrow \$500. He mortgaged his estate, which was worth \$2,000, to the extent of \$500. On failure to pay, the mortgagee was entitled to take the whole estate.

The actual purpose of a mortgage is merely to give security for the debt, and this view has for a long time been taken by the courts of equity. The debtor is permitted on payment of the debt and damages to the creditor to petition for the redemption or restoration of the land. A certain time is given the debtor to find the money or lose his right. This right of the mortgagor is called *Equity of Redemption* and can not be waived by any stipulation in the mortgage. The States have statutes requiring suits of different kinds to be brought within certain periods, usually in about twenty to twenty-one years after the debt falls due. But equity now gives the mortgagee power to cut short the right of redemption, by means of foreclosing.

Status of the Mortgage To-day.—In many States the mortgage is regarded as a lien which the mortgagee has in the mortgaged premises, the mortgagor still being the legal owner, subject of course to the lien held as security for the debt. The mortgage while in form a conveyance is restricted by its defeasance clause and equity of redemption to a mere security. The mortgagor is entitled to remain in possession of the mortgaged premises until failure to pay, or to perform his obligation. After that the mortgagee may enter into possession. Of course stipulation may be made that the mortgagee may have possession, but it is not usual.

Form of the Mortgage.—A mortgage is in the form of a formal deed, with the addition of the defeasance clause. No particular form is necessary for this clause, and so long as it shows that conveyance is merely to secure payment of a debt, it constitutes the conveyance a mortgage. A court of equity will accept proof going to show that a certain instrument, though a deed in form, is in reality a mortgage, the defeasance clause being made orally by declaration in court.

A specimen mortgage is here shown :

[Specimen Mortgage]

THIS INDENTURE,

Made the.....*fifth*.....day of.....*September*.....
in the year One thousand nine hundred and eight.....

BETWEEN.....*George Richards*
.....of the city of Buffalo,
County of *Erie*, and State of *New York*, *part y* of the first part,
and.....*Edward Smith*.....
of the same place.....*part y* of the second part.

WHEREAS, the said.....*George Richards*
.....is justly
indebted to the said *part y* of the second part in the sum of.....
three thousand.....dollars (\$3,000.00....), lawful money of
the United States, secured to be paid by his certain bond or
obligation, bearing even date herewith, conditioned for the pay-
ment of the said sum of three thousand.....
dollars (\$3,000.00....) on the *first* day of *July*, nineteen hundred
and ten, and the interest thereon, to be computed from this date
at the rate of five per centum per annum, and to be paid semi-
annually on the first days of April and October in each and
every year until the whole of said principal sum be fully paid,
with the privilege to the party of the first part, his executor,
administrator or assigns, on any day when interest is payable, to
pay off the principal of said mortgage in sums of *one thousand*
dollars or more

NOW THIS INDENTURE WITNESSETH, That the said
part y of the first part, for the better securing the payment of the
said sum of money mentioned in the condition of the said bond
or obligation, with interest thereon, and also for and in con-
sideration of one dollar paid by the said *part y* of the second
part, the receipt whereof is hereby acknowledged, *do es* hereby
grant and release unto the *part y* of the second part, and to his
heirs (or successors) and assigns forever.....

ALL THAT TRACT OR PARCEL OF LAND, situate in
the.....city of.....Buffalo.....County of.....
Erie.....and State of *New York*, bounded and described as
follows, viz.: Beginning at a point in the northerly line of
Forest Avenue three hundred and twenty-three (323) feet east-
erly from the easterly line of West Street; running thence east-
erly along said line of Forest Avenue three hundred and seventy
(370) feet; thence northerly two hundred and fifty-two (252)
feet; thence westerly and parallel with Forest Avenue three
hundred and seventy (370) feet; thence southerly two hundred
and fifty-two (252) feet to the place of beginning.....

TOGETHER with the appurtenances, and all the estate and
rights of the *part y* of the first part in and to said premises.

TO HAVE AND TO HOLD the above granted premises unto the said *part y* of the second part, *his* heirs and assigns forever.

PROVIDED ALWAYS, That if the said *part y* of the first part, his heirs, executors or administrators, shall pay unto the said *part y* of the second part, *his* executors, administrators or assigns, the said sum of money mentioned in the condition of the said bond or obligation, and the interest thereon, at the time and in the manner mentioned in the said condition, then these presents, and the estate hereby granted, shall cease, determine and be void.

AND the said *part y* of the first part *covenant s* with the *part y* of the second part as follows:

That the *part y* of the first part will pay the indebtedness as hereinbefore provided, and if default be made in the payment of any part thereof, the *part y* of the second part shall have power to sell the premises herein described, according to law.

IN WITNESS WHEREOF the said *part y* of the first part *ha s* hereunto set *his hand and seal* the day and year first above written.

In Presence of
ALFRED JONES

GEORGE RICHARDS (Seal)

STATE OF NEW YORK,	} ss.
County of.....Erie.....	
City of Buffalo.....	

On this.....fifth.....day of.....September.....
in the year One thousand nine hundred and eight.....
before me, the subscriber, personally appeared.....
George Richards.....to me personally known
to be the same *person* described in and who executed the fore-
going instrument, and *he*.....acknowledged to me
that *he* executed the same.

(Notary's Seal)

CHARLES E. DALE,
Notary Public for Erie County, New York.

The mortgage may contain one or several covenants or warrants, which are inserted to furnish additional security to the lender.

1. Covenant to keep the buildings on the land insured against fire.

2. Covenant as to power of sale or foreclosure of the property by the mortgagee upon failure to pay any part of the principal as agreed.
3. Covenants to pay interest, taxes, and assessments levied against the property; and upon failure to pay within a certain number of days, the right to consider the whole debt due, and to act as if the time allowed for its payment had expired.

Bond.—As a rule when a mortgage is given to secure a debt, it is accompanied by a note or bond, making the mortgagor personally liable. The mortgagee thus has personal security in case the value of the mortgaged property is not large enough to wipe out the debt on foreclosure. The bond is usually drawn so as to contain the same covenants as the mortgage, while notes are in the ordinary form. The bond or note, however, is not necessary to the validity of the mortgage.

Recording the Mortgage.—Most of the States require by statute that mortgages be recorded with the public recorder of the county of location. This is to render the mortgage effectual against third parties who purchase subsequently, or are second or third mortgagees, or creditors. In some States, it is provided that the mortgage does not become effective till received for record; and that a mortgage first recorded is superior to another though of earlier date of signature, which is not presented for record till later. The time of its receipt for record is stamped by the recorder on the mortgage. For instance, two mortgages are taken on a house and lot. One is signed on the 7th, the second on the 11th of the month. The second is recorded first and takes preference over the other in the event of default.

Discharging the Mortgage.—As a mortgage is given in security of a debt or obligation, it is satisfied by repayment, or by performance of the obligation. It is discharged by the mortgagee, whether payment is made at the appointed time or after, but before an action to foreclose is begun. A specimen discharge follows:

[Discharge of Foregoing Mortgage]

STATE OF NEW JERSEY, }
County of Essex..... } ss.
Town of Montclair..... }

I, Henry Wilson, of the Town of Montclair, County of Essex, and State of New Jersey,..... DO HEREBY CERTIFY, That a certain Indenture of Mortgage, bearing date the.....fifth.....day of.....September.....in the year One thousand nine hundred and eight.....made and executed by *George Richards*, of the first part, to *Edward Smith*, of the second part,.....and recorded in the office of the Clerk of the County of.....Erie.....State of New York, in Liber.....756.....of Mortgages, page.....17.....on the.....fifth.....day of.....September.....1908,.....at two o'clock, P. M., which said mortgage was duly assigned to me by the said *Edward Smith*, the mortgagee above named, by assignment dated the third day of June, 1909, and recorded in the Clerk's office of Essex County, State of New Jersey, in Liber 460 of Mortgages, at page 110, on the third day of June, 1909, at four o'clock P. M.....is, together with the bond.....secured thereby, fully paid, satisfied and discharged.

Dated the.....fifth.....day of }
December.....1910, }

HENRY WILSON (Seal)

STATE OF NEW JERSEY, }
County of Essex..... } ss.
Town of Montclair..... }

On this.....fifth.....day of.....December.....in the year One thousand nine hundred and ten.....before me, the subscriber, personally appeared.....*Henry Wilson*.....to me personally known to be the same *person* described in and who executed the foregoing instrument, and *he*.....acknowledged to me that *he* executed the same.

(Notary's Seal)

JOSEPH BROOKS,
Notary Public for Essex County, New Jersey.

The repayment may be made by the mortgagor himself or by a purchaser of his interest. In order to extinguish the mortgage as entered in the records, a formal discharge is executed and recorded in its turn, so that nothing will stand on the records against the estate.

Subrogation.—If any one, other than the mortgagor, who has an interest in the estate, pays the debt to protect his own interest, he is entitled to have the benefit of the mortgage. For instance, A has a mortgage on B's property to the amount of \$4,000. B gives a note for that amount signed by C, as guarantor. If B is unable to pay, and C is consequently called on to do so, he has a right to B's benefit in the mortgage.

Foreclosure of Mortgages.—If the mortgagor does not pay the debt secured by the mortgage as agreed, then the remedy of the mortgagee is foreclosure. That is, he has a right to file a petition in a court of equity craving that the mortgaged premises be sold, and the proceeds applied to the payment of the mortgage debt and costs of the action, the balance to go to the mortgagor. The court may thereupon decree that the property be advertised and sold, and the proceeds distributed as stated. This action destroys the mortgagor's equity of redemption, and all his rights to the property.

All persons who have interests in the property must be made parties to the action, so that claims, if any, can be heard; and the property must be advertised in the papers for a certain time before actual sale. Should the property not bring enough to pay off the debt, then a personal judgment on the bond or note is taken for the balance, this being called a *deficiency judgment*. Both actions may be obtained at the same time.

Mortgages containing a covenant of foreclosure entitle the mortgagee, on default in payment, to proceed to advertise and sell. The mortgagee, however, is not permitted to purchase the property for himself, unless allowed by stipulation or statute, and the sale must be public and bona fide.

Second Mortgage, etc.—A mortgagor may place as many mortgages on his property as he is able to obtain, and second and third mortgages on property are common. The securities are not confined to real estate but also include its fixtures. Unless there is any stipulation to the contrary, the mortgages take priority according to their date. Thus the holder of a second mortgage would get nothing till the holder of a first mortgage was paid; that is, unless the holder of the first had neglected to record, and the holder of the second had recorded the instrument, in which case the second mortgage would take precedence.

Effect of Foreclosure on a Second Mortgage.—If the first mortgagee forecloses, then he bars the second, and if only enough money is produced by the sale to satisfy the claims of the first, then the second mortgagee loses. If there is a balance left, this goes to the latter. If the second mortgagee forecloses, he bars any mortgagee following. If he sells, what he gets is subject to the lien of the first mortgagee.

Assignment or Transfer of Mortgages.—The mortgagee may, if he wishes, sell or transfer the mortgage to another. This he does by a written contract of sale transferring his interest in the mortgage—called an “assignment”—in which he gives the assignee who takes the mortgage all of the rights of the assignor, but no others.

The assignment should always state these rights in exact terms.

When a debt secured by a mortgage is assigned, the assignee should at once notify the mortgagor so that payment may now be made to the assignee. A mortgagor is allowed to dispose of his interest in the mortgaged premises before satisfying the mortgage. If he sells the mortgaged premises, the buyer agreeing to take over the mortgage, the buyer must repay the mortgagee. The mortgagee by his acceptance of the buyer as his new debtor relieves the original mortgagor.

A specimen assignment is here shown.

[Assignment of Foregoing Mortgage]

THIS INSTRUMENT, Made this.....third.....day of
June,.....1909
 BETWEEN *Edward Smith*, of the City of Buffalo, County
 of Erie, and State of New York.....of
 the first part, and *Henry Wilson*, of the Town of Montclair,
 County of Essex, and State of New Jersey.....
 of the second part,

WITNESSETH, That the *part y* of the first part, for a good
 and valuable consideration to.....him.....in hand paid by
 the said *part y* of the second part, *has* sold, assigned, transferred
 and conveyed, and *do es* hereby sell, assign, transfer and convey
 to the *part y* of the second part a certain mortgage bearing date
 the.....fifth.....day of.....September.....1908,
 made by.....*George Richards*.....
 to *Edward Smith*, said *part y* of the first part,.....to secure
 the payment of the sum of three thousand.....dollars
 (\$3,000.00....), and interest thereon from the date thereof.....
recorded in the Clerk's office of
Erie.....County, State of New York, in Liber.....
 756.....of Mortgages, at page.....17.....on the.....fifth
day of.....September.....1908, at.....two
o'clock p. m., together with the bond accompanying said
 mortgage and therein referred to, and all sums of money due and
 to grow due thereon. And the *part y* of the first part hereby
covenant s that there is now.....due on said
 bond and mortgage the sum of two thousand dollars (\$2,000.00).

IN WITNESS WHEREOF, the said *part y* of the first part
has hereunto set.....*his*.....*hand* and *seal* the day and
 year first above written.

EDWARD SMITH (Seal)

.....(L. S.)

STATE OF NEW YORK, }
 County of.....Erie.....} ss.
 City of Buffalo.....}

On this.....third.....day of.....June.....in
 the year One thousand nine hundred and nine.....
 before me, the subscriber, personally appeared.....
Edward Smith.....to me personally known to be the
 same *person* described in and who executed the foregoing in-
 strument, and *he*.....acknowledged to me that
he executed the same.

(Notary's Seal)

WILLIAM J. WALLACE,
 Notary Public for Erie County, New York.

New Idea in Mortgages.—During the last two or three years the use of what is known as participation mortgages has become quite frequent, and, when conservatively used, these are of service to both the lender and borrower. Here an investor who considers the security offered satisfactory, for a certain amount, say at 5 per cent, but the loan more liberal than could really be obtained at that rate, agrees to make it "in participation." That is, he enters into it with some other lender who will loan a less amount at, say, half of one per cent. less interest, taking as security an assignment of the mortgage made to the first lender under an agreement between them that lender number two shall collect interest on the entire loan at 5 per cent, retain $4\frac{1}{2}$ per cent on the amount he has advanced, and pay the remainder to lender number one, who thus receives 5 per cent on the advance he has made, and half of one per cent on the advance made by the lender with whom he participates.

The advantage to the borrower is that he gets a liberal loan on the first mortgage at a moderate rate of interest, and is still free to negotiate a second mortgage, if he desires. The advantage to lender number one is that he receives a large return on a comparatively small advance. The advantage to lender number two is that he obtains a conservative investment at a fair rate of interest. This form of mortgage has been criticized, but has received the approval of banking interests; and when employed with discretion its use seems open to no valid objection.

Mortgages as Investments.—The good real estate mortgage has the first requirement of any safe investment, which is stability. Land is the most stable of all security. It can not shrink, save by earthquake or flood, and these disasters are infrequent; it can not move away; it is not susceptible to panic or depression. It is, as most people know, the one permanent basis of the world's wealth.

Summed up, the principal advantages of the real estate mortgage as an investment are these:

1. When well selected it is an investment without speculative features, for the principal neither rises nor falls in value.
2. It permits a revision of the rate of interest at stated periods. This means that if the mortgage comes due when money rates are high the lender can raise the rate and take advantage of the prevailing money conditions. With a bond, on the other hand, the rate is fixed all the time.
3. It is an investment which is visible, and which the investor can watch at all times.

In buying a mortgage the investor should lay down certain rules which if followed in other investments will be found helpful. First of all, he should find out the nature of the property mortgaged. It may be a dwelling-house or a store, and it must produce income. Then it is a good plan for him to go out and look it over. In an investment where you can see for yourself, never take anybody's word.

At this point comes an important fact that the mortgage buyer should know and heed: a mortgage is always more desirable for investment when it is on a house in which the owner lives, or on a store in which he does business. The reason is quite obvious. If the house is his home it is reasonable that he will keep it in good condition, and that he will make every effort to make payments promptly. If it is his store he will find it to his profit to make it attractive to customers.

The amount of money loaned on a mortgage is of great importance. It should never be more than two-thirds of the valuation put on the property. If the house is valued at \$3,000, the mortgage should not be more than \$2,000.

The dower rights of a wife may cause unpleasant complication if they are not considered when the mortgage is executed. It has often happened that a man claimed to be single when he gave a mortgage. Later, when the property was foreclosed or sold, it developed that he had a wife and she had dower rights in the property.

5. LANDLORD AND TENANT

We now come to an entirely different class of estates in land, called leasehold estates, which are for a fixed or determinable period of time. There are four divisions, which may be defined as follows:

1. Estates for years.—An estate for years is an estate limited to a definite and ascertained period of time, such as an estate for a month or a year or any number of years, and is usually created by lease, commonly called a leasehold. The estate remaining in the landlord is called a reversion, because at the end of the lease, the estate reverts to him. A lease for years is therefore one for a definite time, such as a lease running for a period of five years from a certain date; or a lease for one year from a certain date, even if payment is to be made monthly.

2. Tenancies at will are those which may be terminated at the will of either party. They are uncommon and not favorably regarded by the law, and are wherever possible construed as being from year to year, instead of at will. It has been sometimes held that a tenant, who at the end of his lease for years is allowed by the landlord to remain on, is a tenant at will, but most courts regard him as a tenant from year to year.

3. Tenancies from year to year.—A tenancy from year to year is created by lease, ending at a definite period of time and continuing for similar periods, unless terminated by notice from either landlord or tenant. It may be for a week, or a month, or a quarter of a year. Sometimes the lease is spoken of as one from week to week, or from month to month, but that does not alter the procedure. The tenant who stays on at the end of his week or his month signifies his intention to remain for another week or a month. So too with a year, the tenant who continues after the expiration of his year without notice from the landlord has his lease for another year. If he has given no notice himself he is held to have taken the lease again and is liable for rent.

4. **Tenancies by sufferance** are those which arise when the tenant remains, at the expiration of his lease, without his landlord's consent. He is then a trespasser and may be ejected by the landlord, by means of proper proceedings. Most States now forbid forcible entry. If the landlord consents to his remaining, the tenant then becomes the holder of a tenancy from year to year.

Leases.—The lease is the agreement by which a landlord conveys an estate for years to a tenant. The owner granting the lease is called the landlord, or lessor, and the estate reverts to him at the end of the lease. The person to whom the lease is granted is the tenant, or lessee. If the lease is for a longer time than one year, it must be in writing. In some States this law is only applicable to leases in excess of three years. Usually a lease may be made orally if only for a year or less; but in certain States in which writing is not specifically required, recording is, so that to be effectual against purchasers or encumbrances, the lease must be written. In some States, leases can be made only for a limited number of years.

Covenants of the Lease.—Any further agreement beyond the ones as to time, place, and consideration may be made in a lease. The express ones almost always inserted are the covenant by either landlord or tenant, as arranged, that one of them will pay taxes and assessments; the tenant's covenant to surrender up the premises to the landlord in as good condition at the end of the term, necessary wear and damage by the elements excepted. Other express covenants may be that the landlord will renew the lease if desired or make repairs to buildings; or that the tenant will not assign or sublet. There is an implied covenant on the tenant's part to pay rent, and to make ordinary repairs, which need not go further than keeping the house wind and water tight. If the premises leased is a farm, then it is implied that the tenant shall cultivate it in proper manner. There is an implied covenant on the landlord's part that he has a

right to make the lease, and that the tenant shall have quiet enjoyment of the premises, as against disturbance by the lessor or any one claiming superior title, but not against trespassers or others of that nature. A specimen lease follows.

[*Specimen Lease*]

A LEASE

Made and executed BETWEEN.....*Thomas Burns*
.....of the.....City.....of.....Knoxville.....
Tennessee, of the first part, and.....*George Rogers*
.....of the.....City.....of.....Richmond.....
Virginia, of the second part, this.....second.....day of
.....March.....in the year One thousand nine hundred
and nine.....

IN CONSIDERATION of the rents and covenants hereinafter expressed, the said *part y* of the first part *has* DEMISED AND LEASED, and *do es* hereby demise and lease to the said *part y* of the second part.....the following premises, viz.:

A dwelling house, situated on the east side of Park Street, between Allen Street and North Street, and known as 724 Park Street, Knoxville, Tennessee.....
with the privileges and appurtenances, for and during the term of.....one year.....from the.....second.....day of
.....March.....1909, which term will end on the first day of March, 1912.....And the said *part y* of the second part *covenant s* that *he* will pay to the *part y* of the first part for the use of said premises, the.....monthly.....rent of.....fifty.....dollars (\$50.00....), to be paid monthly in advance.....

AND PROVIDED, said *part y* of the second part shall fail to pay said rent, or any part thereof, when it becomes due.....
.....it is agreed that said *part y* of the first part may sue for the same, or reenter said premises, or resort to any legal remedy.

The *part y* of the.....first.....part *agree s* to pay all
.....taxes to be assessed on said premises during said term except the water tax.....

The *part y* of the second part *covenant s* that at the expiration of said term *he* will surrender up said premises to the *part y* of the first part in as good condition as now, necessary wear and damage by the elements excepted.

WITNESS the hands and seals of the said parties the day and year first above written.

THOMAS BURNS (Seal)
GEORGE ROGERS (Seal)

Form of the Lease.—Examination of the foregoing document will reveal its essential features. It must state explicitly the names of the two parties to the transaction; contain a description of the property leased; state the length of time leased, and the consideration. Any special covenants such as taxes and repairs must also be set forth. Most States require leases to be witnessed and acknowledged before a notary public, but they need not be under seal. In a formal lease are given the names and description of the parties, terms of the lease, description of premises let, covenants, and signatures.

It must not be forgotten that the purpose of a lease is to transfer real property—that is land, houses and fixtures—from one person to another for a certain period and upon certain conditions.

Rights and Liabilities under a Lease.—The law does not permit the tenant to decrease the value of the premises in any way. In the matter of defects, repairs, and the use of certain things it is more on the side of the landlord than that of the tenant. His possession, though exclusive unless other stipulation is made, is only temporary, and he must remember this.

Repairs.—The tenant is bound, unless otherwise agreed upon, to make such repairs as are necessary to return the leased premises in the same condition as they were received, ordinary wear and tear excepted. As already mentioned, he must keep them wind and water tight. If the buildings are burned down, or destroyed in any way by accident, he is not compelled to rebuild or bear the expense of rebuilding them, except in a few States where statute has not prevailed over the common law. In making repairs, the tenant may use timber on the estate.

Waste.—The tenant is not permitted to commit waste on the premises, and if he does so, renders himself liable in some cases to forfeiting his estate, or to damages three times the estimated value of the thing used, or injury done. For instance, he may not open new mines on the land, though he may use those already opened. But he may remove clay and sand, or dig up the land in such

a manner as not to injure it. He may not cut down timber except for fuel and repairs.

Defects.—The tenant takes the premises as they were when the lease was executed, and there need be no implied covenant that they are in good condition, or tenantable, or fit for any particular purpose. The tenant, however, may demand an express covenant to this effect from his landlord. If the tenant takes possession, nothing being said about the condition of the premises, and finds out afterward that they are uninhabitable on account of defective plumbing, or inefficient sanitary arrangements, or other causes, he is not released from his lease and is liable for the rent.

There is a limitation to the above, however. The landlord is not permitted to let a tenant enter into possession of buildings containing some concealed or dangerous defect which would cause injury to the tenant, such as dangerous weakening in stairways, floors, etc., infection of disease from former tenants, etc.; and if injury results from such defects the landlord is held liable for damages.

Fixtures.—This subject has been treated earlier (see page 880).

Title.—The tenant can not deny his landlord's title while in possession under the lease, and it constitutes a fraud if he gets possession under a lease and then sets up an adverse claim. If a tenant recognizes the title of his landlord by accepting the lease, or by paying rent, he can not dispute it during his tenancy.

Rent.—The sum or consideration which is paid by the tenant to the landlord for the use of premises under a lease is called *Rent*. It is agreed upon in the lease, and is payable until the termination of the lease or its surrender, or the eviction of the tenant. The tenant may or may not occupy the place, or he may rent it for another, but he can not get away from payment of the rent. If, during the running of the lease, he voluntarily leave the premises without consent of the landlord, he is still liable. The landlord may accept the premises and cancel the remainder of the lease, if he can get another tenant. Or

he may relet on behalf of the tenant, and collect any sum by which the rent received falls short of the first tenant's agreed-upon rent.

Rent Both Personal and Real Property.—Strange as it may seem, rent is both personal and real. When it is not due it is real property, and should the landlord die before the date on which it is due, it goes to the heir. If, however, it is due and payable at the time when the landlord dies, it is personal property and goes to the executor.

Remedies for Non-payment.—Should the tenant fail to pay his rent, the landlord is entitled to several remedies at law:

1. He may sue and recover judgment by means of an ordinary action for debt, which may be levied on any property the tenant may have. The tenant may raise a counteraction stating that the landlord has failed to perform all of the conditions of the lease.

2. If the lease provides that non-payment terminates the lease, or if it is so provided by the statutes, the landlord may take possession of the premises, but he is not allowed to make forcible entry, the actual ejection being performed by an officer of the court, after complaint has been filed with and judgment given by the court.

3. In some States the crops grown by the tenant may be held by the landlord who has a lien over them.

4. By distress. This method is not recognized by many States, and where it is, is regulated entirely by statute. By it the landlord gives bond and files an affidavit with a court as to the amount due and his claim to it. An officer of the court may then take possession of the personal property of the tenant, and if the case when argued goes against the latter, his goods are sold and proceeds applied to the payment of the sum due.

Termination of the Lease.—A lease comes to an end as follows:

1. By expiry of the period, if made out for a term of years.

2. By breach of covenants, constituting forfeiture. If

the tenant commits a breach of any covenant agreed by stipulation in the lease to form a forfeiture, the landlord can declare the lease forfeited.

3. By surrender. That is, the tenant arranges to give up the premises and the landlord accepts it. There is no surrender if the tenant merely walks out without the assent of the landlord, either implied or expressed. Such would only be a breach of contract and the tenant would be liable. Notification to the landlord is not enough; there must be acceptance by him.

4. By the extinguishing of the landlord's title. For instance, the landlord who is only a life tenant may die, or a claimant to the title may dispossess the landlord.

5. By statute in some States, if the buildings are totally destroyed through no fault of the tenant. This does not apply at common law unless only a part of the destroyed buildings was leased to the tenant.

6. By notice, if made from year to year. Three months' notice is usually given if the lease is for periods of a year; one month before, for a month; and so on, giving notice equal to the length of the period. Until the notice has been given, the landlord is still considered to hold the tenant as such, and can not evict him. Similarly, the tenant is liable for rent for another period unless he has given notice.

Transfer of Lease.—The landlord may assign a lease, and the tenant on receiving notice from him or the new landlord must pay the new landlord the rent due. If no notice is given, and the tenant pays to the former landlord, then he is no longer liable in any way for his rent.

Unless restrained by a clause in the lease, the tenant may assign his estate in the premises, but should he do so, he loses his estate. He is still liable for rent, even though he agrees to accept as tenant the person to whom assignment was made, or indicates an implied arrangement by acceptance of rent from the assignee. A grant of the tenant's whole interest is regarded by law as an assignment.

Subletting.—A grant by the tenant, however, of only a part of his interest, a part of the time, or a part of the premises, is a sublease. Thus the tenant may have an estate of ten years, and grant one for eight. The sublease is the tenant of the lessee, or original tenant, and pays rent to him. The tenant is permitted to sublet the premises unless restrained by the lease, or unless the statutes have provisions contrary to subletting without consent of the landlord.

It is sometimes difficult to say where subletting begins, but it has been held that letting rooms by the week is not included, and that neither is the giving the use of a barn to a neighbor. In fact the mere granting of privileges or favors does not constitute it.

If the tenant, in contradiction to stipulation, sublets, the landlord may eject the sublessee, and sue the tenant for damages for breach of contract.

The tenant who is allowed to sublet is himself still liable for the rent of the premises, even though the landlord agrees to take the rent from the sublessee, and does take it. The original tenant is surety for the subtenant, unless the landlord expressly releases him. The subtenant takes over all the obligations required by the tenant's lease, and is bound to repair and use the property according to it.

The Tenement House Law.—Cities of all sizes must inevitably suffer from overcrowding in some quarter or other of their area, and this is particularly noticeable in those older districts in which rents are lower than elsewhere. It is there that the poorer classes congregate, often with a careless disregard of the defective and unhygienic condition of their dwellings. It is hard to fix the blame upon any one. The tenement dweller accepts the conditions with comparative cheerfulness. The room is never too small to crowd in another person. The air is never too impure for a family to be reared in. Mysterious epidemics of disease are regarded as natural, and are never attributed to any source of domestic infection. The law, however, regards all this as prejudicial and, in



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fact, a positive menace to the general health of a city, and rules have been framed for the guidance of the landlords owning such property. Tenement houses must be built in accordance with these laws, and old houses, if they can not be altered to conform as nearly as possible to the law, are declared uninhabitable. It is, therefore, to the interest of the landlord to execute such alterations as are required.

One great evil of the old type of tenement house was the multitude of unlighted and unventilated bedrooms. In New York, an incomplete canvass in 1902 showed 361,661 rooms with light and ventilation below the ordinary standards. In 1909 there were still 364,217, of which 101,117 were rooms totally dark; but at the end of that year one-half of the latter had been improved. Importance must also attach to well-lighted, well-ventilated hallways in tenements. The dark, ill-ventilated hallway is an unfailing reservoir of foul air for every apartment on which it opens, and its darkness gives a cover to all sorts of uncleanness. It is as detrimental to moral conditions as to physical. Much can be done and has been done by the aid of skylights and glass panels in the doors.

Fire Dangers.—Danger from fire is the peril most generally feared in tenements. Though actual loss of life is, very fortunately, of comparatively infrequent occurrence, yet the horror of such happenings, when they do occur, is sufficient to warrant the taking of every possible precaution against them. With regard to protection from such danger, fire-escape balconies are being provided in old buildings, besides being required in every new tenement erected. Provisions of the law for fireproofing yard space, and yard egress, size of courts, and the type of fire-escape required, reduce not only the possibility of loss of life, but of the spreading of fire to other buildings, or adjacent parts of the same building. In confirmation of this may be adduced the fact that not a single life has been lost by fire in any "new-law" tenement in New York, while records and photographs of this department

show many interesting instances where a serious fire has been confined to its immediate source by its inability to cross a wide court, or to pass the fire-stops provided in the construction.

The New-law Tenement.—There are over 15,000 new-law tenements in New York City, completed and occupied, containing something like 160,000 apartments and an approximate population of 750,000.

It is hardly necessary to point out the significance of these figures. It indicates that not only the natural increase of population, but a considerable number in addition, displaced by the demolition of old tenements as business encroaches on former tenement districts, may be housed in dwellings free from the old evils of dark rooms, dark halls, narrow air-shafts, or none, and insufficient or foul water-closet accommodation.

The new-law tenement affords ample court and yard space, safe construction with regard to protection from fire, and rooms all opening upon the outer air, thus receiving the light and ventilation necessary for maintaining proper sanitary conditions, and preventing the spread of tuberculosis and other contagious diseases.

When it is considered that, by the activities of the Tenement House Department, more than a million people, for whom accommodation has been provided since its organization, have been freed from the necessity of living in the dark, unsanitary buildings of the older type, this one circumstance alone would be sufficient measure of accomplishment, if none other existed.

Principal Regulations.—The following are some of the principal regulations of the Tenement House law, as required by cities of the first class:

A tenement house is defined as any building occupied or intended to be occupied by three families or more, and includes buildings known as apartment houses and flats.

Purchasers of tenement property, before passing title, should search the records of the Tenement House Department to ascertain what violations (if any) of the

Tenement House Act are pending against such property. Such searches will be made by the Department free of charge for all persons having a legitimate interest in the matter.

Before any tenement house can be lawfully occupied, the law requires that the builder shall receive a certificate from the Tenement House Department, to the effect that the building has been erected in accordance with the provisions of the Tenement House law. Real estate operators should refuse to make loans unless such certificate is produced. If a tenement house is occupied without such a certificate, it is provided that during such unlawful occupation any note secured by a bond or mortgage upon the building or the lot upon which it stands may be declared due at the option of the mortgagee, and that no rent shall be recoverable by the owner or lessee of the premises for the period.

Registry of Owners' Names.—Every owner of a tenement house must file in the Tenement House Department the following information: Name and address of owner; street, number, and address of the house; number of apartments, number of rooms in each, and number of families occupying each. In case of transfer, notice must be given to the Department.

Janitor.—Wherever there are more than eight families, and the owner does not reside on the premises, there must be a janitor or housekeeper residing there.

Fire-escapes.—All non-fireproof tenement houses must have fire-escapes, reached directly from one room in each apartment. Fireproof tenement houses do not require this.

Rooms.—Alcove rooms are prohibited. No room can be subdivided so as to make dark a portion of the room. In every tenement house hereafter erected, every room except water-closet compartments and bath-rooms must have at least one window opening directly upon the street or yard. Bath-rooms and water-closet compartments may open on vent shafts. Rooms must be at least nine feet high, and seventy square feet in area, with one room of 120 square feet in each apartment.

6. DEALING IN REAL ESTATE

The business of real estate is divided roughly into three classes, as follows:

1. *Investments*, or the employment of capital in the acquisition of real estate for permanent ownership or actual use of the person acquiring it.

2. *Operation*, or the acquisition of land for commercial operations, such as purchasing, developing, and selling, or even for mere speculation.

3. *Agency*, dealing in real estate on behalf of others for compensation, which may be either buying or selling for others, or managing their property.

1. Realty as an Investment.—Real estate as an investment is becoming more desirable than in the past, owing to a number of things, among them the quickness with which titles are now examined and insured by title companies; the improved facilities for borrowing on bond and mortgage; and the continual enhancement in land values due to increased population, growth of cities, spread of good roads, extension of railroads, development of waterways, etc.

This removes one of the objections formerly made to real estate investment by those who are accustomed to investing in stocks and bonds—that the holder has no market in which to sell even at cut prices.

The real estate market does not offer the opportunities for sudden wealth, such as offered by other markets, but for safe investment it is probably the best of them all. Since 1897 there has been an era of advancing prices throughout the world, and the holders of real estate have profited largely by it.

The Best of Securities.—An anonymous writer in the "Saturday Evening Post" says: "No security is better than well selected land; therefore the mortgage on it, when properly safeguarded, is a stable investment. The principal advantages of the real estate mortgage are: it

neither rises nor falls in value, and is therefore not speculative; it permits a revision of interest rate at stated periods—with a bond the rate is fixed; it is an investment that you can see with your own eyes.

"It is not difficult for the dweller in the small town or in the country to get a small mortgage for his first thousand; but what is the city man or woman to do? Mortgages in large communities are for many thousands of dollars. The title companies have come to the rescue of the small investor by issuing mortgage certificates. They are certificates issued against a group of big mortgages. They pay four and a half per cent interest a year and run for ten years. They may not only be had in thousand-dollar pieces but also in denominations of two hundred dollars and five hundred dollars. If one of the mortgages comprising the group behind the certificates should mature and be paid off during the life of the certificate, another is put into its place. Thus the security remains intact. Many of the certificates are guaranteed both as to principal and interest, and the issuing company mails the interest checks to the investor. This same method has been employed in farm mortgages, and thus a highly desirable form of investment has been made available to people who live outside the farm centers.

"There is no safer employment of the first thousand than in a home. Of course, you can't buy a house for this sum, but you can make the first payment on the property with it, and then, by executing a mortgage, have an incentive to keep on saving, and eventually own your place free from debt.

"Many people, however, make the mistake of buying improved property as an investment with their first savings, quite forgetful of the fact that there is always the hazard of having no tenants, of fire and other kinds of loss. Besides, the fixed charges, such as insurance and taxes, keep on."

2. Operating in Real Estate.—The operator in real estate to-day is rarely a speculator. He studies conditions and possibilities with the most scrupulous care and cau-

tion, and has elevated his calling to a profession. He usually confines himself to one city or certain sections of it, if a large one, and specializes. There is nothing too unimportant for him to notice, as an indication of increasing values. If he can anticipate a movement such as the movement of trade up-town in New York, driving the center of population before it, he is in a position to make his capital grow by leaps and bounds. He must note the increase of wealth and population, the tendencies to spread or to condense in certain neighborhoods. The past trend of trade and its future course, the natural courses along which improvement must win. For instance, a broad street is almost sure to become of greater value than a narrow one; or a street leading to some specific point, as a railroad station, etc. Land in sections devoted to shopping, amusements, clubs, hotels, etc., has a value of its own, which, however, is usually shifting, and the operator must watch every symptom of movement carefully.

As a natural part of his business he must know what is required for modern improvements, the amount of land, the capacity of a building needed to create a profitable investment, cost of construction, income desired, rates and terms upon which he can borrow money; transit facilities present and future, and many other things which he encounters daily in his profession.

Dealing in Improved Property.—The first aim of an operator who buys a building is to increase its rental value. He may do this by seeking a better mortgage on which a less rate of interest is payable. He may buy land with a view to demolition of the present building; or of holding it for a rise in prices. On the other hand he may indulge in structural alterations, bringing the building more in line with modern requirements, improving its front, or putting in larger windows, changing its character, as turning a dwelling house into an office building; putting in elevators, steam heating, electric light, improving service, etc. It is important, however, to know before purchasing whether the building can be

changed so as to bring it up to the standard required by the neighborhood.

Points in Purchasing.—The most important points to be considered in purchasing are: prominent or advantageous location of the ground in connection with transportation facilities to the nearest marketing center; the physical surroundings; price; terms of sale; and encumbrances, such as mortgages, liens, unpaid taxes and assessments.

Having had the records searched, and an abstract furnished showing no encumbrances against the title, the purchase price paid, and all deeds recorded, plans can be made to develop the property. When a tract is bought for subdivision into building lots, the land should be surveyed by a competent engineer, and as soon as the plan is approved by the city authorities, preparations can be made to place the tract upon the market.

Methods of Payment.—When an ordinary piece of ground is purchased for development purposes, payment may be made in several ways. It may be made in cash and notes followed by mortgage, or it may be in cash down without further burden. In many cases to-day the lots are sold on the instalment plan, the interest and taxes being carried by the owner of the tract, and generally the deed is not passed until the full amount has been paid up. The purchaser, when he buys, is given a land contract (see p. 892) in which he agrees to make certain cash payments periodically until the total sum is paid.

Value of Plots.—The value of the plot or plots depends, first, on the general value of the property in the section where located, and, second, on the topographical conditions and location as regards the laying out of streets. No matter, however, what conditions obtain as regards above the cost must be approximately the same, if the plots are of the same size. If they are, then the total number of plots divided into the cost would give the cost

per plot. If the dimensions vary, then the total number of square rods divided into the total cost would give the cost per square rod, and each plot would be charged proportionately.

Costs to be Reckoned in Purchasing.—*Acquiring*: The purchase price, and interest on it. Cost of maps, etc. Legal expenses, advice, drawing deeds, recording.

Maintaining: Taxes; advertising, including printing, signboards, etc.; grading; fencing; labor, transportation, freight, express and drayage, telephone and general upkeep of the property.

Improvement: Formation of streets, driveways, roads, sewers, and lighting connections, seeding and sodding, tree planting.

3. Real Estate Agency.—Agency, as we have defined it, is dealing in real estate on behalf of others for commission. This divides itself naturally into (1) buying and selling, and (2) leasing and managing.

Buying and Selling.—In the selling of real estate, as in everything else, intensive salesmanship is the first requirement. The quality of knowing exactly what you have to sell, what you want for it, and what class of a buyer you want to reach is invaluable. The real estate broker who is successful is the person who conserves and directs his energies in one channel, not many. He does not offer a property to each and all comers in the hopes of their buying. The man interested in tenement property will not handle office buildings or high-class apartments. Therefore to circularize him, and try to convince him that he ought to, is often wasted energy and time. By following sales and noting names of buyers and the class of property they buy, it is possible to get a list of prospective customers arranged according to their property likes and dislikes. The first economy effected will be the saving of mail which would otherwise find its way to the waste-basket. When the agent has the property in his hands for sale, he will know by reference to his lists

who will be likely to be interested in the proposition, and he can then apply a concentrated salesmanship.

What has been said, under selling, as to the requirements of a salesman applies equally well here. The person who places his property for sale on the broker's lists, and the person who buys it, are largely influenced by the appearance, character, and the other convincing attributes of the salesman. The broker must know his business; but furthermore, he must know the property he is going to sell, and its value. When he is buying for a client, he must be able to foresee probable increases in value, or be able to uncover weakness in the seller's argument. He must never, so far as he can avoid it, induce his client to pay a price which is not warranted by future events. In any case, the wise broker watches the development of the neighborhood in its change of tenancy, character of buildings, improvement in transportation facilities, and other things affecting value. By following other sales, a good idea of current prices can be had, though this should be dealt with merely as an indication and not as a working basis.

Showing the Property.—It is well known that the prospective buyer of anything at all, if shown a multiplicity of objects, will end by buying nothing. So too in showing houses. The prospective buyer rushed through a score of houses in one morning emerges from the last with an aching head and a determination to live in a hotel for the rest of his days. It is possible to elicit from most people a faint idea of what is wanted; a few know what they are looking for; and the house required must not differ from that preconceived idea. It can be taken for granted, however, that the average man, assisted by his wife, has some idea of their wants. The wise broker will select half a dozen places from his list which appear to offer some possibility of being suitable, and confine his salesmanship to the merits of that half dozen. He will not din into his buyer's ears the incredible advantages of the houses he is showing. He has eyes of his own, and if he wants open fireplaces

where the broker can only offer steam heat, then nothing the broker can say will make him see the heaters as glowing fires. The desirability of the property can be thrust home without massacring the buyer's sensibility as to his own perception of things fit. Above all do not misrepresent facts. Facts about a house are usually very evident, and it is not worth while to exaggerate, if misrepresentation is going to invalidate the contract and spoil one's reputation for fair and open dealing.

Closing the Sale.—The broker has two prices to bring to one level, that of the seller which is usually high, and that of the buyer which is usually low. It is his duty to get them equal, and the moment they agree is the moment to get the contract signed. Neither seller nor buyer must be allowed the time to change their minds, and the broker who knows the moment of coincidence, and only stops long enough on it to get the contract signed, is earning his commission as an expert in more than real estate brokerage.

Oral, not Written, Offers Best.—One of the best known real-estate brokers in New York says that the broker when representing a purchaser should never make a written offer for property, as the letter may be used by the owner's broker as a lever in raising prices. For example, he may show the offer to other prospective purchasers, and by pointing out the evident value set upon the property by a broker of good standing induce them to raise their offers. Thus the first offer is used to procure competitive offers against itself. If the offer is made orally, then there is nothing to show, and only the broker's word to quote, which might be regarded merely as a seller's inducement.

When Commission is due a Broker.—It is not sufficient for a broker to go to an owner and tell him he has a client who is willing to buy, get his terms and the price, and proceed to effect a sale, afterwards claiming commission from the owner. The employment must be

direct, or capable of proof pointing to contract of employment. The case of *Pierce vs. Thomas* (4. E. D. Smith, 354) furnishes the following statement of the principles involved:

"To entitle a broker to recover commissions for effecting a sale of real estate, it is indispensable that he was employed by the owner to make the sale. A ratification of his act, where original employment is wanting, may in some instances be equivalent to an original retainer, but only where there is a plain intent to ratify. An owner can not be enticed into a liability for commissions against his will. A mere volunteer without authority is not entitled to commissions, merely because he has inquired the price which an owner asks for his property and has then sent a person to him, who consents to take it. A broker has no better claim to recover for voluntary service rendered without employment and not received and acted upon by the owner as rendered in his behalf than any other volunteer."

Selling by Auction.—The real estate broker who conducts auction sales must have decided ability in his own lines. He must be able to reply to every inquiry in a convincing way. He must also have the gift of attracting attention to his sales by advertising. The advertising may be done through various mediums—the press, circularization, etc., but it must be such as to give a faithful idea of the property, and induce visitors to look at it. The more people can be induced to visit the property, the more chance there is for a sale, though many will be found to buy on mere statement. The actual sale commences with the reading of the terms of sale. After this, the different points of value of the property are touched upon; instances of neighboring sales which have proved profitable, probable future developments, suggestions for buildings, and profit to be made from them, all in plain effective language without glibness. The purchaser must believe in what he is buying.

Bids are then taken. It is the business of the auctioneer to raise them to the highest possible level, and

the expert knows how to handle a crowd, which in the excitement of bidding is apt to get out of control. Bidders must not be held in one continuous strain, for they are apt to feel the strain and leave. Any incident which relieves the strain and gives them time to lose some of the tension should be seized upon; but it should never be allowed to interrupt the sale by diverting attention from the real business. The auctioneer is there to sell and he is going to sell the property at the best price possible, which may be less than the appraisal price. He can only do this by knowledge of the psychology of a crowd. This, as much as any one thing, makes the successful auctioneer.

Leasing.—The broker who leases properties for owners, makes use of the following methods. He prepares a complete list of everything to rent in the district which he covers. He places his own "to let" signs on the premises. He gets in touch with those tenants whose leases are shortly to expire, by means of a canvass. He interviews them months beforehand—six months is not too much—and finds out their requirements. It is his business then to fill these requirements as best he can without incurring responsibility for the owner of the property by rash promises as to alterations and repairs. It is always best to get references, both from a former landlord to satisfy the owner of the property, and from the future tenant to satisfy himself. References from a tenant should be from a bank if possible. If references are refused, or are unsatisfactory, all that need be said to the proposing tenant is that his application is declined. There is thus no possibility of being involved in libel suits for defamation of character. It is highly important that when the lease is drawn up, any repairs or alterations that have to be made should be set down specifically, and agreed to by both parties. There will then be no cause for disagreement after entry into the premises.

Appraising Real Estate.—The value of land is based primarily upon its capacity to produce profit in the form

of rent. It is value as a whole, or fee value, which is the rental value capitalized at the current rate of interest on money. For example, an estate yielding a net annual rental of \$2,000, after payment of all charges, has for purposes of appraisement a rental value of \$2,000. This sum capitalized at 5% gives the fee value of \$40,000, and is the least amount for transference of title. Of course, the property when put in the open market may bring much more, and its market value may be anything over \$40,000. In that case a new proprietor may consider it advantageous to himself to raise the rental proportionately.

The Valuation.—The first step in determining the value of any parcel of land as customary among appraisers, is: Determine the value of one city lot 25x100 situated midway in the block, on the street or avenue in which the property to be valued is situated. Suppose this to be \$10,000. The parcel of land contains 4 lots. We then find the value as follows:

Lot 1, (the unit of value).....	\$10,000
Lot 2, next to it.....	10,000
Lot 3, next to the corner lot add 10%	
of the unit, \$10,000 + \$1,000.	11,000
Lot 4, corner, add 60% of \$11,000 +	
\$11,000	17,600
	\$48,600
Add plottage, 10%.....	4,860
The total valuation of the parcel is....	\$53,460

It may be asked how the various percentages are arrived at; how is it possible to say with any degree of exactness what is the proportionate difference of value which enables us to say that one lot is worth so much more than the one next to it? Instead of 10%, why not 15% or 20%? Why should the corner lot be worth 60% more than the one next to it? These relative values are approximations based upon long experience, and are

the result of closely following auctions and sales and noting prices. This rule, however, does not hold in every case. For instance, in factory districts, the corner lot is often valued at only 50% more than the adjoining lot. This is explained by the fact that the frontage is not so important as in lots where window display would increase the value of the frontage to a greater extent than that of the area.

The corner lot is more valuable than the others: (1.) Because it furnishes a greater area for window space, thus increasing the supply of light and air; and (2.) because it has a greater frontage, say, 125 feet as compared with 25 feet of the inside lots. It thus presents a greater opportunity for window display, and greater advertising prominence.

Building and Lot.—When a building has to be taken into consideration, practically the only measure of value is that of rental. What it costs to construct, except in the case of one newly put up, does not in any way indicate its present value. Even if it is new it may not be suited to the purposes of the neighborhood, and consequently its value is much impaired. If the building is not perfectly new, its value is decreasing year by year through wear and tear and changes in the locality, and its present value is doubtful. Old buildings, which are no longer an improvement to the land, are often thrown in with the land at the price of the latter alone. So that, finally, the appraiser begins with the rental value.

For instance, take a lot 25x100, worth \$20,000, that is with a rental value at 5% of \$1,000. If we erect upon this lot a six-story modern tenement at a cost of \$25,000, we have a total investment of \$45,000, upon which we find that, according to the average rate of interest on equal security, we ought to get 5% net out of the ground value and 6% net out of the building value, or \$2,500 clear per year out of the whole. At this rate the lot portion of the investment pays \$1,000 and the building \$1,500. Upon estimating the cost of operating such a tenement, where hot water (but not steam heat) is sup-

plied night and day to the tenants, and allowing \$500 a year for depreciation of value, we find that it will be necessary to get a gross rental of at least \$4,800 for the whole, to be collected from tenants occupying 52 or 65 rooms. In order to pay such an aggregate rental each tenant will be obliged to contribute about six dollars per room per month. If this estimated rental proves to be higher than that which is paid by others in the same or similar locality, then such a tenement is not the proper improvement for the lot, or is not the most economical form of improvement. In order to make this lot available for the purpose of a tenement house improvement, therefore, it becomes necessary to adopt a more economical method of improvement.

Another lot adjoining at \$20,000, is therefore added, and the new six-story improvement covering 70% of 50x100 will contain double the number of rooms, and will cost only \$45,000 to build, a saving of \$5,000 in construction. This makes the investment \$85,000 and the gross rental \$9,600. In this house only one staircase is required, having an air-shaft twice as large as in the first instance, and but one hot water heating plant of a little larger size, so that proportionately the cost of operating is considerably decreased and the whole proposition becomes more valuable because it is more profitable.

In estimating the cost of modern buildings, the following scale is an example given by Mr. E. H. Gilbert:

"Five-story tenements, built on 25x100, cost, as is well known, within the limit of \$15,000 to \$20,000, or at the rate of eleven to fifteen cents per cubic foot.

"Six-story modern non-fireproof tenements, without elevators, commonly known as 'walk ups,' cost from twelve to sixteen cents per cubic foot to construct, and are usually built on lots larger than 25x100, of which they can not cover more than 70%, while the old style twenty-five-foot house could use 75%. They are usually of very cheap construction and built to accommodate the families of day laborers whose earnings are near the bottom of the scale.

"Six-story elevator apartment dwellings, non-fireproof, cost from fifteen to eighteen cents per cubic foot to build, and accommodate quite a large class of people who are able to pay from \$7 to \$10 per room per month.

"Seven-story elevator apartment dwellings which are called semifireproof, vary in cost between somewhat wider limits. Fireproof apartment dwellings of greater height cost from twenty-five to fifty cents per cubic foot to erect.

"Non-fireproof store and loft buildings cost twelve to eighteen cents per cubic foot, and the same, called fireproof, to any height, built of steel, cost from eighteen to thirty-five cents per cubic foot.

"Office buildings cost from twenty-five to fifty cents per cubic foot.

"Stable property, garages and factories cost from fifteen to twenty-five cents per cubic foot, according to character of construction."

New buildings are estimated at their probable first cost, and the value of the land is added to obtain the value of all.

The process of computing the cost of construction is to obtain the area of land covered, the height of the building, calculate its cubical contents in feet, and multiply by the figure determined upon as probably representative of the cost of building per cubic foot.

The unit of cost of construction is worked out from the average experience of the appraisers. The cost of a number of typical buildings is ascertained to lie within certain limits, and constant association of those units so derived, with certain forms and appearances of construction, enabled one to make close approximations of actual cost (or what that cost should reasonably have been), to suit the purpose for which the building was erected.

7. BUILDING AND LOAN ASSOCIATIONS

The object of building and loan associations, when they were first formed, was to assist the man of small means to build a home of his own; and while this is still

their chief aim, they have extended their scope of operation in various other directions, notably to the provision of means for regular and systematic saving.

The ordinary association, while it has a certain authorized capital stock, may really be classed as a mutual concern. It has no fixed capital stock, but any person may become a stockholder by conforming to certain requirements, and is entitled at will to withdraw the cash value of his stock. Certain associations have, however, progressed beyond that stage, and are now of the capitalized class, having a fixed, and in several cases, a fully paid-up stock. No new stock is issued, they accept only deposits on certain conditions, and business is conducted after the manner of a banking house.

How the Scheme Works.—The scheme at first appears complex, but it is simple enough. For instance, a person wanting to save a thousand dollars subscribes for ten shares of stock in an association and becomes a member. Every shareholder is supposed to pay \$5 a month on every \$1,000 subscribed. The average rate of interest or dividend is about 6 per cent, and at this rate, compounded semiannually, it takes the dues of the shareholder about $11\frac{1}{2}$ years to equal the amount of his subscription, as against 16 years by the ordinary savings-bank plan. Suppose, however, that the person desires to borrow the money at the start. The association takes a first mortgage on his property, and pays over to him the amount, thus enabling the borrower to live in his own home while he is paying his dues, instead of waiting the eleven years until he has accumulated the amount. By paying \$10 a month on the \$1,000 the borrower at the end of the period will get his canceled mortgage, while the non-borrower paying \$5 on every \$1,000 will receive the full sum subscribed in the same length of time.

Opening an Account.—Any one wishing to become a stockholder of a building and loan association may do so by making application at the office of the company. The amount of stock to be purchased will be governed by the

amount which he wishes to deposit each week, although it is customary to require at least twenty-five cents a week for each \$100 of stock subscribed for; but the payments may be made at this rate weekly, monthly, or quarterly, as may suit the convenience of the depositor. For instance, if the applicant thinks he can spare \$2.50 each week out of his earnings, he will subscribe for ten shares of stock. He may deposit that amount weekly, or \$10 a month, or \$30 quarterly. In most institutions the amount of stock for which any member may subscribe is limited, as minors may become stockholders. However, a parent may subscribe for the limited number of shares for each of his or her children.

Upon making application for ten shares of stock, the applicant must not only pay his first instalment of \$2.50 in advance, but he must also pay a premium of twenty-five cents for each \$100 shares of stock subscribed. His first week's dues, therefore, amount to \$5, and on payment of them he is given a pass-book.

On the first page of every pass-book is printed a "certificate of stock," such as the following:

CERTIFICATE OF STOCK

(Date)

Certificate of Stock, No.....

This certifies that.....is entitled to
Shares of Stock No....., in
 THE OHIO SAVINGS AND LOAN COMPANY,
 subject to the Constitution and By-Laws of the said Company.

.....
 Secretary.

This certificate is evidence of the ownership of the number of shares of stock subscribed for, subject to the conditions of the constitution and by-laws of the association. When his weekly payments, and such dividends as may be declared, amount to the face value of the stock,

he is entitled to receive the amount of his subscription in cash.

Payment of Dividends.—The “dividend periods” of building and loan associations are usually on the first day of January and the first day of July. The dividend is declared by the directors after deducting from the earnings all expenses and losses, and such sums as may be placed in the surplus account, dividing the residue *pro rata* among all the members in proportion to the amount paid in as dues on stock, and not the full face value of the stock. Those who become members between January 1st and July 1st do not receive their dividend until the following January; and those subscribing between July 1st and January 1st do not receive their dividend until the following July. If the stock is withdrawn or cancelled before that time, the member forfeits the dividend.

Fines.—When a member fails to pay the regular dues on his stock he is subject to a fine. This fine does not usually exceed five cents on each \$100 of stock. In case a member should fail for eight successive weeks to pay his dues, the directors may declare his stock forfeited. The amount of fines assessed will then be deducted from the dues paid in, plus dividends declared, and the remainder will be held subject to the order of the member.

Withdrawal.—Stockholders may withdraw from the company at any time the entire stock which they have paid in, by giving two weeks’ notice to the board of directors. Upon giving notice they are no longer liable for the payment of dues, and cease to participate in any further dividends, but are entitled to receive all payments made on the stock and all dividends that have been declared up to the time the notice to withdraw is given. A member may also withdraw any part of his paid-in stock upon these terms. It is usually provided, however, that if the applications for withdrawal should exceed the weekly receipts, the applications may be filed in the order in which they are received and paid in

the order in which they are filed, as fast as the receipts of the company will permit.

Giving notice of withdrawal does not terminate a member's liability for losses sustained by an institution. A withdrawing member does not cease to be a stockholder until he has surrendered his stock and been paid in full.

Transfer of Stock.—Any stockholder may sell to another the stock standing in his name on the books of the company, and for the convenience of those members who may desire to transfer their stock, there are usually printed in the back of the pass-book two or three blank forms similar to the following:

TRANSFER OF STOCK

.....19.....

For Value Received, I hereby transfer to.....
all my claims, rights, and interest in.....shares
of the capital stock of

THE MASSILLON SAVINGS AND LOAN COMPANY,
of Massillon, Ohio,

this.....day of.....A. D. 19....

Attest:

.....

Secretary.

All transfers must be made in writing and are not binding with the company until the transfer is made on their books and the certificate of stock and pass-book surrendered.

Not only may individuals become stockholders in a building and loan association, but companies or corporations may become members. Stock may also be taken jointly in the same name of two or more persons, whether adults or minors, in which case the joint owners must sign and file a "joint order."

Many societies receive deposits without making it necessary for the depositor to become a stockholder. They not only issue Certificates of Deposits, payable at a fixed time and drawing a certain rate of interest, but also receive small weekly or monthly desposits, the depositor receiving an ordinary savings pass-book upon which are entered his deposits as they are made. Most deposits received by local companies, however, other than "Stock Deposits," are on certificate account.

The following is the form of a Certificate of Deposit:

CERTIFICATE OF DEPOSIT

No.

\$.....

Massillon, Ohio, ... 19.....

This certifies that.....

Has Deposited In
THE MASSILLON SAVINGS AND LOAN COMPANY,
of Massillon, Ohio,

..... dollars, payable
to the order of.....
on the return of this certificate properly endorsed, subject to the
conditions printed on the back hereof. The certificate will bear
interest at the rate of four per cent per annum from date until
paid.

Not Subject to Check.

.....
Secretary.

The certificates of deposit issued by building and loan associations differ to some extent, though immaterially, from those generally issued by banks. One form is given, which serves as a receipt, and upon which the depositor must sign his name. On the back of the certificate are usually printed the conditions under which the money is held and under which any funds may be withdrawn.

How Loans are Made.—The other important function performed by a building and loan association, besides issuing stock to members and receiving deposits, is that of lending money. Loans may be made to any person, partnership, or corporation, on any security approved by the board of directors, but probably more than ninety per cent are made on the first mortgage security.

The secretary must present the borrower's application to the board of directors at their next weekly meeting, and the board must act upon it before the loan can be made. In order to avoid delay, however, a blank application form should be filled out and signed by the applicant, giving complete and explicit information concerning the borrower himself, and the property offered as security. It must state the amount of loan desired, the rate of interest to be paid, conditions for payment of principal, what the property is worth, what was paid for it, encumbrances, liens or judgments against it, whether the taxes are all paid, and whether it will be kept insured for the benefit of the company. The secretary then at the next meeting of the board presents the application, and if the board think favorably of it, they will instruct the "committee on securities" to examine the property and notify the attorney to look up the title. Sometimes, in order to save time, the secretary may at once notify the committee on securities to examine the property, and the attorney to examine the title, in order that the application blank will be complete, and the board enabled to act upon it at the first meeting after the borrower has applied for the loan.

At the bottom of the application blank the secretary completes the record of the acts done in connection with the transaction, by certifying as to the meeting and date upon which the loan was granted.

All application blanks are filed away in proper order, making a complete record, whether the loans were granted or not.

In passing upon an application, the board of directors must first satisfy themselves that the property offered is ample security for the loan, and in determining this they

must take into consideration the location, the neighborhood, the physical condition of the property itself, the condition of the surrounding property, the rents, etc.

Character of the Property.—Property may be conveniently accessible to a street-car line, railroad station, or the business section of the town, or its location may not offer any of these advantages. The neighborhood may be desirable, or undesirable. The property may be all run down or in good repair. The surrounding buildings may be old and unsightly, or comparatively new, with well-kept lawns and neat and orderly surroundings. Rents may be low on account of the number of vacant houses in the neighborhood, or unusually high because of the desirable locality and scarcity of rentable property. These facts can be determined only after a careful and thorough investigation.

Character of the Borrower.—"The next most important thing in connection with making a loan is the character of the borrower," says Edgar G. Alcorn, to whom we are indebted for other statistics. "The board wishes to know whether or not the man to whom they entrust the money of their members is honest, sober, industrious, of good habits and economical. Even if there was no question whatever about the security, they would in no case be justified in making a loan to one of questionable character, with no regular employment, or with extravagant and intemperate habits. Before making a loan the board should be satisfied that there was no reasonable grounds for supposing that the mortgage would ever have to be foreclosed. The purpose of a building and loan association is to loan money, and not to own and rent property, however safe and profitable it may be.

"Some associations have an inflexible rule that no loan in excess of two-thirds of the appraised value of the property can be made. Others, however, are more liberal in this regard. The mission and purpose of the building and loan association being to enable the small wage-earners to become the owners of their homes, such an ironclad

rule, they contend, would tend to defeat the very purpose of the institution. Sometimes an applicant for a loan of money wants the money to pay off the mortgage held by some other party or institution. Such an application is always carefully investigated. The association will ascertain the reasons for his wanting to transfer the loan, even though the security be quite ample. They will want to know whether the borrower is reliable, steady, and of good habits, or whether he has been slow in paying his interest and otherwise is a source of trouble to the lender. No prudent association wants to have any dealings with a shiftless, dilatory person, though they may be well protected and may even derive some element of profit by his negligence.

Title Assured.—"Before mortgage loans are finally accepted, it must be ascertained whether or not the borrower has a good title to the property. No matter how much greater the value of the property may be than the loan, if there is a material defect in the title the security may be rendered worthless.

"Unless the borrower already has an abstract of title, the attorney must ascertain for himself that the title is clear. In some cases it is necessary to make a personal examination of the county records even when an abstract of title accompanies the application, for the reason that the abstract may not be properly sworn to, or may not have been made by an abstracter or an attorney known to the board.

"If the borrower does not carry insurance, the rules of the company will make it compulsory for him to get the property insured and turn over his insurance policy with the loss clause properly endorsed. The usual and simple form of loss clause is as follows: 'Loss, if any, under this policy, is payable to the Blank Building and Loan Co., as its interests may appear.'

"A tickler or card index is usually kept showing the expiration of all insurance policies. Agents may neglect to notify a borrower of the expiration of his policy, and as the borrower himself is not likely to keep track of it,

it is necessary that the associations do so for their own protection. They usually notify the borrowers about a month before the expiration of their policies in order to give them ample time to have them renewed.

Small Loans Preferred.—"It is the policy of most of the building and loan associations to give preference to small loans rather than large ones. Being an institution especially adapted to the needs of the 'poor man,' its aim is to help build 'little homes' and not mansions. Besides thus fulfilling its mission, the smaller loans procure greater safety and usually bring a higher rate of interest.

"Owing to the fact that the loans are to be repaid in small weekly or monthly instalments, the transaction calls for special forms of note and mortgage adaptable to the contract on which loans to stockholders are made, differing to some extent from those generally used by other financial institutions or by individuals.

"Sometimes a stockholder may need a small amount of money temporarily, and to avoid making a withdrawal of part or all of his credits and thus having his stock canceled, he may secure a loan to the extent of his paid-up stock by signing a note and stock assignment and depositing his pass-book with the company."

A New Idea in Mortgages.—A new form of mortgage now being introduced by some building societies in the East is known as the divided mortgage, its object being to enable the borrower to acquire a more valuable property, taking a longer period to pay off the debt.

Really, under this plan, two separate mortgages are issued. A borrower from a building and loan association, for example, who pays thirty-five dollars a month on a house worth thirty-five hundred dollars, might have got a house worth forty-five hundred dollars for the same payment under the divided mortgage plan. In that case the building society would have drawn up one mortgage for twenty-five hundred dollars, on which he would have paid twenty-five dollars a month, and more than half of each payment would have gone to extinguish the princi-

pal, under the diminishing interest plan. Then a second mortgage for two thousand dollars would have been drawn, and upon this he would pay ten dollars a month simple interest, carrying it until the first mortgage had been cleared off. In actual interest, of course, this divided mortgage would cost more in the long run. But against the greater cost would be set the years of actual possession of a better house.

Building societies can not do much directly for the man seeking a mortgage, unless the latter has at least twenty-five per cent of the value of the property he wants to acquire in cash or real estate. But the secretary of a New Jersey building society has devised a plan for helping even the man who has saved next to nothing.

As an example, a young couple just married had put their surplus cash into furniture. They found a house that could be bought for twenty-five hundred dollars. It was distinctly a bargain. The building society could only loan two thousand dollars on mortgage, however—it was against the State laws to take a greater risk. But a capitalist in that town had placed some money at the disposal of the secretary to meet such emergencies, and five hundred dollars of this was borrowed on the second mortgage at four per cent, the money being paid to the building society, added to the two thousand dollars lent on the first mortgage, and the whole paid for the house, into which the couple immediately moved as owners. This second mortgage, of course, was not a first lien on the property until the first had been satisfied. But the couple began paying twenty-five dollars a month into the society, and when accumulations over and above the interest on both mortgages—amounting to a total of ten dollars a month—had reached five hundred dollars, the society paid off the second mortgage. This plan is one well worth the attention of employers. In the New Jersey society where it originated not a dollar of money loaned on such a second mortgage has ever been lost.

Every Man his own Landlord.—"There is no reason nowadays why one should not be his own landlord," says

a writer in the "Saturday Evening Post." "Every opportunity is afforded the prudent to invest savings in real estate or to acquire property under burden of mortgage. The papers sing the joys of rural homes at easy payments. Building societies offer loans at easy rates. It seems that for the rent one pays, without hope of ever seeing it again, one might by appropriating the same amount or little more to instalments on a house be gradually establishing a full ownership of the house. Instead of rent, it is instalment of payment on something which is practically right away the property of the payer. The thrifty are taking full advantage of these offers, and real estate business is in a flourishing condition. It is usual to take a mortgage on the property, pay a sum down, appropriating the payments to interest on mortgage; or the money may be borrowed from a building and loan association.

"Two men in a certain suburban town bought homes the same spring, paying their savings on account and assuming the mortgages for balances. Both houses cost about the same, and both transactions were practically alike except in one important particular—each purchaser had his own idea about mortgages.

Two Ways of Buying.—"The first man had for several years deposited his savings with a building and loan society in the city. When he wanted to buy a home, therefore, he went to this society to borrow money. He got it at six per cent. His mortgage was put on such a basis that he had to make regular monthly payments, clearing off part of the principal each time he paid interest. The officers of the society supervised his purchase, so that the man who sold him the property had to safeguard him in a number of minor matters that might never have been thought of had he engineered the deal himself. For instance, the house was in a new section through which a sewer was to be extended at some future time. Pending its construction, the builder had led the house drain into a small creek. The building society officers insisted that, if the sewer were delayed and any objection

should be made to such use of the creek, the seller would agree to supply the cesspool of the house. There are several hundred points of this sort to be considered in purchasing property, and the building society officers, through their practical knowledge of real estate transactions, are often able to safeguard purchasers better even than a real estate attorney, for sometimes the latter will have an eye only for strictly legal details.

"As for the second man, he thought it well to shop around for a rate of interest below six per cent. Times were good just then, and he found a widow who was satisfied to let him have money at five and a half per cent. His mortgage, unlike that of the building society, merely bound him to keep up interest, permitting him to pay off the principal as he found it convenient.

"Two years went by, a business depression came, money was at a premium. The widow who had lent the second man funds at five and a half per cent found it necessary to call the loan for her own protection. He had to shop around for money in a panic market, and considered himself lucky to obtain another loan at seven per cent. The difference in interest that he had saved during the two years had amounted to about twenty-five dollars. The cost of making out a new mortgage ran to nearly one hundred, and he was now paying one per cent. more than the man who had got his money from the building society. The latter, too, had been held to regular monthly payments, and so cleared off nearly one-fifth of his debt; whereas the second man, having no obligation but actual interest to meet, had paid hardly anything on his principal. The building and loan mortgage, not being subject to call under any circumstances so long as the payments were kept up, ran right along through the panic."

Nevertheless, the building and loan association is not always the most economical or the wisest method of paying for property. Circumstances must govern cases.

PATENTS, TRADE-MARKS AND COPYRIGHTS

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XXV

PATENTS, TRADE-MARKS AND COPYRIGHTS

I. PATENTS

A PATENT may be defined as a grant, by a national government, of the exclusive privilege of making, using, and disposing of, and of authorizing others to make, use, or dispose of, the subject matter of an invention in the country in which the patent is granted. In the United States the authority to grant patents is exercised, for all practical purposes, solely by the federal government. There is nothing in the constitution or laws to prohibit a State government also from granting a patent, provided it does not conflict with any patent granted by the federal government, but in practise the States have so rarely exercised this power that it may be considered as non-existent.

In thirty-eight years, from 1871 to 1909, the total number of patents issued by the United States numbered 789,819; while those issued by all foreign countries combined totaled 1,713,649. These facts indicate, with a forcefulness that makes further comment unnecessary, the tremendous influence of patents, and consequently of the laws governing their issue, in the industrial life of the nation.

What is Patentable.—Not everything that is new can be patented. A discovery or invention to be patentable must, under the patent laws, have the following characteristics:

1. It must be a new and useful art, machine, manu-

facture, or composition of matter; or a new and useful improvement of any of these; or a new and original ornamental design for an article of manufacture.

2. It must involve not only novelty and utility but also invention.

3. It must not have been in public use or on sale for more than two years prior to the date of making application for the patent.

Each one of these specifications has caused wide debate in courts of law, and has been more fully defined as given below.

1. A New and Useful Art, etc.—The term “art” as used in this connection is synonymous with “process” or “method.” A “process” is not patentable under that name, hence is included under “useful art.” An art may require several processes or several machines to produce the result or manufacture desired. Where chemical action is required to produce the result, or the operation or application of some element or power of nature, or of one substance to another, such methods are called “processes.” When it is the mechanical process or method of producing a result, it is patentable. When it represents the function or abstract effect caused by a process, it is not.

By a “machine” is meant every mechanical device, or combination of devices, even if such device is incapable of use except in connection with other mechanisms. A “composition of matter” is a compound of two or more ingredients to form a new substance. The term “manufacture” partly overlaps both “machines” and “composition of matter.” In addition, it includes all those other articles which, in general language, would be called “products.”

The word “improvement” is used in the patent law in its ordinary sense. An improvement on any of the patentable classes of inventions is itself patentable, if the other elements of patentability are present. The right to a patent is, of course, limited to the improvement, and does not include the art, machine or article improved.

2. Novelty and Utility.—Just what constitutes “novelty,” “utility,” and above all “invention,” is a question which can be decided, in any particular case, only by the courts of law. A few general principles may, however, be given, which are recognized as distinguishing features.

Novelty is not possessed by any article or process which has been either used or known of by other persons prior to its invention, or which has been patented, or described in a printed publication, prior to the invention or discovery.

Utility is possessed by any device that may be applied to any beneficial use, in contradistinction to an invention which is mischievous or injurious to the morals, health or good order of society, or is merely frivolous. The degree of utility of an invention is immaterial. If a device has no obnoxious or mischievous tendency, and may be applied to practical use, however slight, it falls within the legal requirements of utility. It need not be superior to other inventions, already patented, having the same purpose.

What is an Invention.—Invention is perhaps the most difficult to define of all the requisites prescribed by the law for patentability. The general rule is that a device which is merely the result of mechanical skill, i. e., one which arises of necessity and spontaneously in the minds of all those who have become skilled in or acquainted with the particular industry or occupation in which the device is to be patentable, is not an invention. The invention must be such that it would not readily occur to persons skilled in the art. Whether the invention made use of anything in any particular case requiring more than ordinary mechanical skill is, however, a question which can not be answered by applying the test of general definition. The truth is that the word “invention” can not be defined in such a manner as to afford any substantial aid in determining whether a particular device involves an exercise of the inventive faculty or not. It may be well, therefore, to quote a few of the important

principles by which the courts have been guided in their determination of this vexed question.

The apparent simplicity or obviousness of a device does not deprive it of its patentability. Many things appear simple and obvious after they have been done which did not appear so before. In fact, simplicity may constitute the chief value of the device. If it is so simple that it would necessarily occur to mechanics skilled in the art, it is not a patentable invention.

A mere change in the size or proportions of devices and machines, leaving the construction, principles and mode of operation the same, is not invention; but a new effect caused by such a change may involve invention, especially in the case of smaller articles.

A new combination, even of old devices, producing a new and useful result in a more advantageous manner, involves invention and is patentable, provided, of course, that the combination is not so obvious as to be the result of mere mechanical skill. The new and useful result, in addition, must be the joint product of the elements of the combination, and not a mere aggregate of individual results. In other words, the combinations must embrace, first, a novel assemblage of the parts involving invention, and, secondly, a cooperation of those parts to produce a common result. In determining whether a particular device shows patentable invention, the court conclusively assumes that the entire prior state of the art, as well as prior patents and machines having a bearing on the subject, were known to the alleged inventor. It is immaterial that he may be, in fact, ignorant thereof and has actually exercised inventive genius.

3. Limited to Articles Not in Public Use.—A patent is authorized only in cases where the invention has not been put in public use nor on sale in this country for more than two years prior to the application for the patent. This applies to design patents also. The two years public use or sale must have been within the United States in order to invalidate the claim; such prior use in a foreign country is immaterial.

By "public use" is not meant, necessarily, use by the general public, but merely a use in public as distinguished from use in secret. If the inventor utilizes his invention for the purpose of profit or trade it is a public use, even though hidden from the general view. The mere making of the article, however, does not constitute public use or sale. Nor will the forming of a plan, or the making of a model, constitute such a prior use as will defeat a patent, where no working device has been made and used for two years before the application for the patent.

The above are but a few of the important principles which enter into the determination of what constitutes a patentable invention. The object of their presentation here is of course merely to give the layman a general idea of the subject. The subject of the patent law is one of the most involved and difficult in the whole field of jurisprudence, and the application of its principles to any particular case can be accurately made only by those lawyers and jurists who have devoted years to its study.

How to Obtain a Patent.—Only the first and original inventor is entitled to a patent. A patent can not be issued to one that is not the actual inventor of the patent device, even with full consent of the inventor. If a patent has been so issued, it will be held by the courts to be void.

In case of the death of the inventor, the application will be made by, and the patent will issue to, his executor or administrator. In case of the death of the inventor during the time intervening between the filing of his application and the granting of a patent thereon, the letters patent will issue to the executor or administrator upon proper intervention by him.

In case an inventor becomes insane, the application may be made by, and the patent issued to, his legally appointed guardian, conservator, or representative.

Joint inventors are entitled to a joint patent; neither of them can obtain a patent for invention jointly invented by them. Independent inventors of distinct and independent improvements in the same machine can not obtain a joint patent for their separate inventions. The fact that one

person furnishes the capital and another makes the invention does not entitle them to make an application as joint inventors; but in such case they may become joint patentees.

The Application.—Applications for letters patent of the United States must be made to the Commissioner of Patents, and must be signed by the inventor, if alive. A complete application comprises the first fee of \$15, a petition, specification, and oath; and drawings, model, or specimen when required. All papers which are to become a part of the permanent records of the office must be legibly written or printed in permanent ink.

Completed applications are numbered in regular order, the present series having been commenced on the 1st of January, 1900. The applicant will be informed of the serial number of his application.

The application must be completed and prepared for examination within one year after the filing of the petition; and in default thereof, or upon failure of the applicant to prosecute the same within one year after any action thereon, of which notice shall have been duly mailed to him or his agent, the application will be regarded as abandoned, unless it shall be shown to the satisfaction of the Commissioner that such delay was unavoidable. It is desirable that all parts of the complete application should be deposited in the office at the same time, and that all the papers embraced in the application should be attached together; otherwise a letter must accompany each part, accurately and clearly connecting it with the other parts of the application.

The Patent Office issues a free hand-book entitled "Rules of Practise," which it would be well to secure. A careful digest of the more important of these rules is the basis of the present article.

Amendments and Actions by Applicants.—The applicant has a right to amend before or after the first rejection or action; and he may amend as often as the examiner presents new references or reasons for rejection.

tion. In so amending, the applicant must clearly point out all the patentable novelty which he thinks the case presents in view of the state of the art disclosed by the references cited or the objections made. He must also show how the amendments avoid such references or objections.

Appeals.—Every applicant for a patent, any of the claims of whose application have been twice rejected for the same reasons, upon grounds involving the merits of the invention, or for other reasons, may, upon payment of a fee of \$10, appeal from the decision of the primary examiner to the examiners-in-chief. The appeal must set forth in writing the points of the decision upon which it is taken, and must be signed by the applicant or his duly authorized attorney or agent.

From the adverse decision of the board of examiners-in-chief appeal may be taken to the Commissioner in person, upon payment of the fee of \$20 required by the law. From the adverse decision of the Commissioner upon the claims of an application and in interference cases, an appeal may be taken to the Court of Appeals of the District of Columbia in the manner prescribed by the rules of that court.

Design Patents.—A design patent may be obtained by any person who has invented any new, original, and ornamental design for an article of manufacture, not known or used by others in this country before his invention thereof, and not patented or described in any printed publication in this or any foreign country before his invention thereof, or more than two years prior to his application, and not caused to be patented by him in a foreign country on an application filed more than four months before his application in this country, and not in public use or on sale in this country for more than two years prior to his application, unless the same is proved to have been abandoned, upon payment of the fees required by law and other due proceedings had, the same as in cases of inventions or discoveries.

Patents for designs are granted for the term of three and one-half years, or for seven years, or for fourteen years, as the applicant may, in his application, elect.

The proceedings in applications for patents for designs are substantially the same as in applications for other patents. Since a design patent gives to the patentee the exclusive right to make, use, and vend articles having the appearance of that disclosed, and since the appearance can be disclosed only by a picture of the article, the claim should be in the broadest form for the article as shown.

Issue of Patent.—If, on examination, it shall appear that the applicant is justly entitled to a patent under the law, a notice of allowance will be sent him or his attorney, calling for the payment of the final fee within six months from the date of such notice of allowance, upon the receipt of which within the time fixed by law the patent will be prepared for issue.

If the Patent Office should find on file two applications covering essentially the same invention, it invites both applicants to submit written testimony in proof of the time when their invention was made. The patent is granted to that applicant who proves the priority of his invention.

Cases have occurred where the patent was granted, in the absence of more definite claim, to the inventor who first filed his application. One of the most noted of such cases, involving millions of dollars, was the patent granted to the Bell Telephone, over the rival inventor, Graham.

Fees.—Nearly all the fees payable to the Patent Office are positively required by law to be paid in advance—that is, upon making application for any action by the office for which a fee is payable. For the sake of uniformity and convenience, the remaining fees will be required to be paid in the same manner.

The following is the schedule of fees required in the Patent Office:

On filing each original application for a patent, except in design cases	\$15.00
On issuing each original patent, except in design cases....	20.00
In design cases:	
For three years and six months.....	10.00
For seven years	15.00
For fourteen years	30.00
On an appeal for the first time from the Primary Examiner to the Examiners-in-chief.....	10.00
On every appeal from the Examiners-in-chief to the Commissioner	20.00

Date, Duration, and Form of Patents.—Every patent will bear date as of a day not later than six months from the time the application was passed and allowed and notice thereof was mailed to the applicant or his attorney, if within that period the final fee be paid, and the certificate promptly forwarded to the Commissioner of Patents; and if the final fee be not paid within that period the patent will be withheld.

A patent will not be antedated.

Every patent will contain a short title of the invention or discovery indicating its nature and object, and a grant to the patentee, his heirs and assigns, for the term of seventeen years, of the exclusive right to make, use, and vend the invention or discovery throughout the United States and the Territories thereof. The duration of a design patent may be for the term of three and a half, seven, or fourteen years. A copy of the specifications and drawings will be annexed to the patent and form part thereof.

Assignment of Ownership.—Ownership of a patent, or any part of one, may be sold or assigned like any other piece of property. An inventor may dispose of all or part of his interest in his invention, either before or after the issuance of the patent to him. He may sell or assign part interest, or may sell merely the rights to its use or sale in a particular territorial area.

An assignment, grant or conveyance of a patent will be void as against any subsequent purchaser unless recorded

in the Patent Office within three months from the date thereof.

Patented articles must be marked with the word "patented" and the date when the patent was issued.

Caveats.—Formerly, if an inventor conceived an idea for an invention which he lacked time to perfect, he could protect his idea by means of a "caveat." This was a formal document containing specification and oath, and was filed by the Patent Office as a temporary instrument, being operative for one year with privilege of renewal for a second year. This device, however, fell into disuse and was finally abolished, July, 1910.

Canadian Patents.—The patent laws of Canada are modeled practically after those of the United States, and every inducement is offered to the American inventor to procure patents there. The expense to apply for a Canadian patent is \$45 for a simple case, which includes Government tax, agency, and all charges for six years, after which two additional terms of six years each may be obtained by the owner of the patent on payment of \$25 each—making the entire term of the patent eighteen years. The patent may be applied for at the outset for eighteen years, at a cost of \$85.

An application must be filed in Canada not later than during the year following the issue of the United States patent, after which time the invention becomes public property there.

Foreign Patents.—The patent laws of various foreign countries are, as a rule, favorable to American inventors. To insure the validity of a foreign patent, it is best to apply for it before the issue of the American patent. This is necessary in many cases. The provisions of the International Convention, however, enable valid patents to be secured in some cases in England, France, Germany, Austria, and Hungary, even after the issue of the United States patent. In most of the foreign countries not mentioned above, valid patents may be obtained as long as the

invention has not become publicly known in those countries. It should be borne in mind, however, that when the provisions of the Convention can not be taken advantage of, nearly all foreign countries grant patents to the first applicant, whether he be the inventor or not. Thus a delay in filing foreign applications will often enable unscrupulous persons who may have a knowledge of the invention to secure patents therefor abroad ahead of the inventor or his assignee. Formerly the filing of applications for foreign patents was often delayed in order to avoid a shortening of the term of the domestic patent by a premature issue of a foreign patent. The present patent laws of the United States, however, contain no clause limiting the term of the American patent, so that the above-mentioned reason for delaying the filing of the foreign application no longer exists.

The expense of obtaining patents in Europe has been reduced in recent years, and an international agreement greatly aids the present-day inventor. The patent laws of Great Britain and Canada are especially liberal; and it is now the general practise to take out patents in these countries at the same time that they are procured in the United States. France, Germany, and Austria are other favored countries.

Models are not required in most European countries, but the utmost care and experience are necessary in the preparation of the drawings and specifications.

Expenses for procuring ordinary patents in foreign countries are as follows: Great Britain, \$45.00 (provisional patent, six months); France, \$75.00 (one year); Germany, \$90.00; Austria, \$90.00; Hungary, \$90.00; Spain, \$80.00; Belgium, \$50.00; Italy, \$90.00; Russia, \$125.00; Australia, \$125.00. These fees usually include taxes and costs for the first year. The expenses in Central and South America are greater, ranging from \$125.00 in Mexico to \$400.00 in some of the other countries.

2. TRADE-MARKS

The extensive use of trade-marks, and the development of the law protecting them, are of comparatively recent origin. The first recorded suit in America against infringement of a trade-mark dates back no further than 1814. To-day about three thousand trade-marks are registered every year by the Patent Office of the United States. It is difficult to mention a single well-known article of common use or consumption which is not protected by a trade-mark.

The primary function of the trade-mark is to indicate who is responsible for the manufacture of the product or commodity so marked, and to impress upon the mind of the consumer a distinction with regard to its nature or quality, as apart from products coming from other sources, so that he will not make any mistake in ordering. It is also, or is intended to be, in a measure, a warranty of genuineness of the article.

Form of the Trade-mark.—The trade-mark has developed in design and application far beyond its early forms, which employed a few representations of animals and other natural objects, and now includes marks, emblems, symbols, signatures, suggestive names, made-up words, arrangements of numerals or letters, and proper names.

To make a trade-mark valid, it must be:

1. Actually affixed to the goods or to the box, or other container in which they are sold. Words, marks or symbols used in advertisements, circulars, or other similar ways, but not actually affixed to the goods, are not valid trade-marks.

2. Arbitrary in its character. It must not be chosen as obviously descriptive of the character or quality of the product or commodity.

3. Used in lawful trade.

4. Such as to distinguish the article, so that it will not be mistaken for similar articles made by other persons or concerns.

Restrictions.—A trade-mark, however, is subject to certain restrictions, as follows:

1. It must not imitate, or seek to imitate in such a way as to confuse the mind of the public, any trade-mark associated with an article of the same or similar kind.

2. Neither the trade-mark itself, nor any label or advertising matter bearing it, must contain any misrepresentations or any statement calculated to deceive or mislead.

This second requisite is but a particular application of the general principle of jurisprudence, which has been applied in trade-mark cases with great vigor, that he who seeks relief from the court must come into court with clean hands. As a result of the application of this maxim to trade-mark law, there have been many cases where, although the imitation of the plaintiff's labels and trade-marks has been of a most flagrant nature, yet legal protection has been denied him in consequence of some false statement upon his label, or in some publication issued in connection with the sale of his goods. False statements as to ingredients, maker, cures, harmlessness, purity, place of manufacture, and even words not intended to mislead but capable of being misunderstood, have been held sufficient to disentitle a plaintiff to relief against an infringement of his trade-mark.

3. It must not be (subject to certain allowances) a geographical name, a proper name, or the name of a building.

4. It must not be merely the name of some common material, such as "wood" or "leather"; nor the designate of form, size, color, or method of construction, or the means of containing goods, such as a box or bottle, nor the color of the label or the article.

5. It is forbidden also to introduce the flag or coat-of-arms of the United States, or any State or municipality; or to employ as a trade-mark the insignia of the Masonic or any other fraternity; or of the National Red Cross.

If an arbitrary name is selected, and that name later, through successful advertising, comes to be used by the

general public to denote an entire class of articles, the right to the exclusive use of that name is not destroyed. An excellent example of this principle is the word "Kodak," which, while originally coined by the Eastman company for a particular kind of camera, is now used by the public for any make of camera similar in construction, although without vitiating the Eastman rights.

Right of Privacy.—The registration in the Patent Office of the portrait of a living person will not be made until the written consent of such person, or his legal guardian, has been filed there. For example, registration of the names of Colonel Roosevelt, Admiral Dewey, and foreign rulers, as trade-marks, has been declined. The "Gibson Girl" was also refused registration as a trade-mark for shoes, because it referred by association to the type known as the "Gibson Girl," and the consent of the artist who created this type had not been previously secured.

This rule does not apply to the use of the name or portrait of a person long deceased. Where the words "Roger Williams Long Cloth" were applied to cotton cloth it was held that "Roger Williams," though the name of a famous person, is, so applied, a popular title, as would be the names of Washington, Green, Perry, or of any other such celebrities.

Trade-marks Which Conform to a Symbol.—There are many examples of trade-marks employing conventional shapes, such as a heart and diamond, and for this reason care should be exercised to avoid copying an exact device already in use. One of the best known is that employed by the United Cigar Stores Company, the basis of which is a shield; while the railway companies have various triangular, circular, oval, and similar patterns. The name of the manufacturer may be utilized as a symbol, as for instance the suggestion of a suit of armor in Armour & Company's trade-mark, or the colt in that of the Colt's Manufacturing Company, or the savage in that of the Savage Arms Company.

Natural objects have suggested the rock of Gibraltar as a symbol of strength to the Prudential Insurance Company, the hunter for the whisky distilled by a firm of that name, the Heinz pickle, etc.

Geographical names, although not allowed to be used as trade-marks, exhibit certain exceptions. Railroad companies may employ them in their trade-marks, while companies which have by long usage appropriated the names are permitted to retain them, e. g., the "Waterbury," "Waltham," and "Elgin" watches, and the "Kalamazoo" stoves.

Numbers and letters may be used, if there is no intention to indicate a grade or quality.

Signatures have the double security of being protected also by the laws regarding forgery. Among the best known wares employing the signature as a trade-mark are Liebig's Extract of Beef, Kellogg's Corn Flakes, Lyon's Tooth Powder, Campbell's Soups, the Ingersoll Watch, Huyler's candies, and Fletcher's Castoria.

Portraits are not always advisable or appropriate, though the portrait of the manufacturer of Douglas Shoes has proved successful, and also that of Mennen of talcum powder fame. Other examples will occur to the readers of periodicals. The Edison Phonograph Company has used a portrait of Edison in combination with his ornate signature.

The question often arises as to whether it is preferable to adopt a name or a symbol as a trade-mark. It is difficult to formulate a general rule, yet it may safely be said that in most cases a combination of the two will be found preferable to either alone. Goods are almost invariably asked for by the name, and it is the teaching of experience that while it may require only a few weeks to fix a name in the minds of the public, it has usually taken many years to establish a name through the use of a symbol. But on the other hand, a symbol attracts the attention and pleases the eye more readily than does a name. A combination of both forms containing their separate advantages is easier to remember than either alone.

Coined Words and Phrases.—The use of coined words and phrases, which are coming more and more into evidence, is subject to certain restrictions. The words must not of themselves indicate a material, ingredient, quality, or character, though they may convey a warranty of quality or character as applied to the product. Such well-known words are "Sapolio," "Postum," "Gold Dust," "Uneeda," "Jap-a-lac," "Ivory," and "Pearline." A particularly neat manufactured word is "Nabisco," formed from the first two or three letters in each of the words, National Biscuit Company.

Catch phrases may be registered as trade-marks, if they identify certain concerns, and thus indicate the origin of the product or commodity: as "Wilson—That's all."

The value of a good phrase in advertising is extraordinary. A large number of staple articles manufactured to-day are kept in the public mind by advertising slogans, some of which have become so familiar as to suggest instantly the name of the article to which they refer. The expense of making these crisp phrases familiar to everybody is enormous, but their commercial value is correspondingly great. A few of the best known are here given, and probably the reader can supply the name of the commodity in a majority if not nearly all of the examples:

"It floats."

"There's a reason."

"It's a ——. That's all you need to know about a glove."

"There's health in every shred."

"Won't smart or dry on the face."

"The beer that made Milwaukee famous."

"The box that lox."

"The flavor lasts."

"All the news that's fit to print."

"If you see it in the —— it's so."

"Get the habit."

"Tasting tells."

"Let the —— —— twins do your work."

"Have you a little fairy in your home?"

"——; that's all."

"You can pay more, but you can not buy more."

"The memory lingers."

"Like old friends they wear well."

"The kind you have always bought."

"Just add hot water and serve."

"The great spread for daily bread."

"Good morning! Have you used —— soap?"

The Value of the Trade-mark.—There are so many different ways in which a well-established trade-mark has value to the manufacturer, that it is worth while to summarize a few of the points in which the value shows itself.

A good trade-mark which has created an enduring impression on the consumer means first of all reorders, which do not come necessarily because the retailer likes or dislikes the goods, or because the wholesaler has "pushed" the goods, but simply because the consumers have become accustomed to that particular thing and always ask for it.

The good trade-mark means power to the manufacturer. The very fact that the impelling demand comes from the consumer makes it hard or impossible for the retailer successfully to resist that demand, and makes it hard or impossible for the wholesaler to resist the demands of the retailer.

The power given to the manufacturer by a good trade-mark means greater economy. It means more goods are sold with less effort and expense. It means that changes in price, which have been rendered necessary by rise in market rates or raw materials, are accepted by wholesaler and retailer. It means that sales can be kept up at less expense and less effort than would be required to keep up and protect the sales of an article which did not have the prestige of a good trade-mark back of it.

Security of Business.—A good trade-mark also means greater confidence, greater certainty in business. With an article that has no prestige among consumers, sales re-

main at the dead level of competition. Rival houses practically determine what profit the business shall make, and the price at which it shall sell. The success built up this season by mere trading talent may not help next year's sales in the slightest degree, if a concern sells at this dead level. Since it must depend almost solely on trading talent to outwit, rather than to overpower, its competitors, it can not calculate upon any enduring trade or reputation.

But the business which is founded on a strong trade-mark prestige among consumers has a different story to tell. The very fact that such prestige does exist tends to lift the advertised trade-marked business more and more above the common channels, giving it in turn a standing and stability which increase in value from year to year.

Its owners can figure with greater assurance on the results of the next season; for the results have been produced within the house, and are not due to outside influences. They can plan ahead.

Stability of Sales.—A good trade-mark means greater security. It renders the business safer against sudden attacks of competition, whether these attacks are really skilful or made by rash rivals, or whether they are only partly successful or wholly unsuccessful.

The bigger and stronger a trade-mark is, the more consumers it has enlisted; and the more firmly it is entrenched in the retail shops, the less likelihood of any other concern investing the large sums of money necessary to dispute that position.

A Tangible Asset.—A good trade-mark is a tangible and a reliable asset. Many different details, of course, govern the question of the exact amount that asset would realize. It would be determined, first of all, by the extent to which the trade-mark had been successfully advertised, and was thus familiar to the consumer. A statement was recently made in the pages of a reputable magazine that five million dollars was offered and re-

fused for the name of the "Royal" Baking Powder. The item was entitled "A Million Dollars a Letter."

Suppose, for another example, that the plant for the manufacture of Sapolio were destroyed. The trade-mark "Sapolio" would still have its definite value, even though the plant, the company, the office organization, all salvage and insurance, and every penny of capital were wiped out. Going a step further, we will suppose that every cake of Sapolio now on its way between the factory and the consumer were annihilated, and that not a single representative of this concern existed. In that case, the vital point which would prove the value of the trade-mark would be: Would the banks, capitalists, or small investors be willing to advance enough money to rebuild this enterprise and begin anew the manufacture of a product which no longer existed except in name? There can be but one answer to such a proposition, even though the imagined example is extreme. But in the case of every trade-mark that has some prestige among consumers a similar illustration would form the measurement on which a careful outside investor would estimate the realizable value of the trade-mark.

Registration of Trade-mark.—A properly registered trade-mark is protected as private property, not only by the laws of the federal government, but also by those of almost all the States. In practise, however, almost all trade-marks in general use are registered under the federal laws.

Registration secures protection for twenty years, except where the trade-mark is previously registered abroad. The cost of an application, when the trade-mark is a mere name or title, is \$25. When a special design is included, it is usually \$30.

Registration may be renewed any time, thereby making it possible for one to maintain a perpetual monopoly in a trade-mark. In order to be registerable under the federal law, a trade-mark must be in use in interstate or foreign trade. This technical requirement may readily be fulfilled, however, by the shipment of a small con-

signment to any State outside the place of manufacture, or to Canada.

Application for the registration of a trade-mark should be made to the Commissioner of Patents, Washington, D. C. It is best to employ a competent attorney to conduct the business, and draw up and file all papers.

Prints and Labels.—Prints, engravings, chromos, or lithographs relating to articles of manufacture, or to salable commodities, such as artistic advertising prints, are not enterable in the Copyright Office, but are subject to registration in the Patent Office.

While no special provision has been made in the new Copyright Act for the registration of prints and labels, they may be so protected, provided they are not merely trade-marks and are of artistic or literary value.

In this connection the term "print" means an artistic production designed to be used as a description, or as an advertisement, or a manufactured article, but not to be attached to it; while the term "label" comprehends such a production impressed or stamped directly upon the article, or upon a slip or piece of paper or other material, to be attached to such article, or to a box, bottle, or package, for the purpose of designating and describing the contents.

This protection is open to the same persons who may secure protection in the Copyright Office.

In order that a print or label may be registered an application must precede publication. This application must be accompanied by a fee of \$6.

Each of the ten copies of the print or label required to be filed with such application must contain the title. Postage and all other charges on matter sent to the Patent Office must be prepaid; otherwise it will not be received. When registration is made, the Patent Office issues a certificate with a copy of the print or label attached to it. This certificate is covered by the fee of \$6, which, if in the form of money-order, draft, or other acceptable form of remittance, should be to the order of the Commissioner of Patents.

3. COPYRIGHTS

A copyright is an official protection against infringement afforded by the Government. It may be obtained by any one who is the author, inventor, designer, or proprietor of a book, periodical, lecture, composition, map, work of art, print or other work specified below under "Subject-Matter."

Term of Copyright.—Copyrights are granted for a term of twenty-eight years, and may be renewed for twenty-eight additional years, if the renewal application is filed within one year prior to the expiration of the existing term.

Subject-Matter of Copyright.—Section 5 of the Copyright Act divides the works for which copyright may be secured into eleven classes, as follows:

1. Books.
2. Periodicals.
3. Lectures, sermons, addresses.
4. Dramatic and dramatico-musical compositions.
5. Musical compositions.
6. Maps.
7. Works of art.
8. Reproductions of works of art.
9. Drawings or plastic works of a scientific or technical character.
10. Photographs.
11. Prints and pictorial illustrations.

Books.—This term includes all printed literary works (except dramatic compositions) whether published in the ordinary shape of a book or pamphlet, or printed as a leaflet, card, or single page. This term "book" as used in the law includes tabulated forms of information, frequently called charts; tables of figures showing the results of mathematical computations, such as logarithmic tables; interest, cost, wage tables, etc., single poems, and the

words of a song when printed and published without music; librettos; descriptions of moving pictures or spectacles; encyclopedias; catalogues; directories; gazetteers and similar compilations; circulars or folders containing information in the form of reading matter other than mere lists of articles, names and addresses, and literary contributions to periodicals or newspapers.

The term "book" can not be applied to: blank books for use in business or in carrying out any system of transacting affairs, such as record books, account books, memorandum books, diaries or journals, bank deposit and check books; forms of contracts or leases which do not contain original copyrightable matter; coupons; forms for use in commercial, legal, or financial transactions, which are wholly or partly blank and whose value lies in their usefulness and not in their merit as literary compositions.

American Manufacture of Copyright Books.—The following works must be manufactured in the United States in order to secure copyright:

(a) All books in the English language and books in any language by a citizen or domiciled resident of the United States must be printed from type set within the limits of the United States, either by hand or by the aid of any kind of typesetting machine, or from plates made within the limits of the United States from type set therein, or, if the text of such books be produced by lithographic process or photoengraving process, then by a process wholly performed within the limits of the United States; and the printing of the text and binding of the book must be performed within the limits of the United States.

(b) All illustrations within a book produced by lithographic process or photoengraving process and all separate lithographs or photoengravings must be produced by lithographic or photoengraving process wholly performed within the limits of the United States, except when the subjects represented in such illustrations in a book or such separate lithographs or photoengravings are

located in a foreign country and illustrate a scientific work or reproduce a work of art.

Books by foreign authors in any language other than English are not required to be printed in the United States.

In the case of books printed abroad in the English language an ad interim term of copyright of thirty days from registration made in the Copyright Office within thirty days after publication abroad may be secured; but in order to extend the copyright to the full term of protection, an edition of the work must be published in the United States within the thirty days ad interim term, printed or produced within the limits of the United States.

Application for Registration.—The application for copyright registration required to be sent with each work must state the following facts, without which no registration can be made:

1. The name and address of the claimant of copyright.
2. The nationality of the author of the work.
3. The title of the work.
4. The name and address of person to whom certificate is to be sent.
5. In the case of all published works the actual date (year, month, and day) when the work was published.

In addition, it is desirable that the application should state for record the name of the author. If, however, the work is published anonymously or under a pseudonym, and it is not desired to place on record the real name of the author, this may be omitted. In the case of works made for hire, the employer may be given as the author. By the nationality of the author is meant citizenship not race; a person naturalized in the United States should be described as an American. An author, a citizen of a foreign country having no copyright relations with the United States, may secure copyright in this country, if at the time of publication of his work he is a permanent

resident of the United States. The fact of such permanent residence in the United States should be expressly stated in the application. Care should be taken that the title of the work, the name of the author, and the name of the copyright claimant should be correctly stated in the application, and that they should agree exactly with the same statements made in the work itself.

The Copyright Office issues blank forms for applications which will be forwarded upon request.

Mailing Applications and Copies.—All mail matter intended for the Copyright Office should be addressed to the "Register of Copyrights, Library of Congress, Washington, D. C." Matter designed for deposit in this Office will be transmitted by the postmaster free of charge, who will also, when requested, give a receipt for matter so delivered to him for transmission.

Fees.—The fee required to be paid for copyright registration is \$1, except that in case of photographs it is only 50 cents when no certificate of registration is desired.

All remittances to the Copyright Office should be sent by money-order or bank draft. Postage stamps should not be sent for fees or postage. Checks can not be accepted unless certified. Coin or currency enclosed in letters or packages if sent will be at the remitter's risk.

Publishers may, for their own convenience, deposit in the Copyright Office a sum of money in advance against which each registration will be charged.

Registration.—After the publication of any work entitled to copyright, the claimant of copyright should register this claim in the Copyright Office. An action for infringement of copyright can not be maintained in court until the provisions with respect to the deposit of copies and registration of such work shall have been complied with. A certificate of registration is issued to the applicant and duplicates thereof may be obtained on payment of the statutory fee of 50 cents.

Notice of Copyright.—The ordinary form of copyright notice for books, periodicals, dramatic and musical compositions is "Copyright, 19— (the year of publication), by A. B. (the name of the claimant)." The name of the claimant printed in the notice should be the real name of a living person, or his trade name if he always uses one (but not a pseudonym or pen name), or the name of the firm or corporation claiming to own the copyright. The copyright notice should not be printed in the name of one person for the benefit of another. The beneficiary's name should be printed in such cases.

In the case of maps, photographs, reproductions of works of art, prints or pictorial illustrations, works of art, models or designs for works of art, and plastic works of a scientific or technical character, the notice may consist of the letter C, enclosed within a circle, thus ©, accompanied with the initials, monogram, mark, or symbol of the copyright proprietor. But in such cases the name itself of the copyright proprietor must appear on some accessible portion of the work, or on the mount of the picture or map, or on the margin, back, or permanent base or pedestal of the work. The notice must be in legible characters.

The prescribed notice must be affixed to each copy of the work published or offered for sale in the United States. But no notice is required in the case of foreign books printed abroad seeking ad interim protection in the United States.

Assignments of Copyright.—A copyright registration may be assigned by the holder of same to a second party, it being necessary that the deed of assignment be recorded in the Library of Congress, to give constructive notice to any third party.

When a copyright has been assigned, the instrument in writing signed by the proprietor of the copyright may be filed in the Copyright Office for record within six calendar months after its execution without the limits of the United States, or three calendar months within the United States.

After having been recorded, the original assignment will be returned to the sender with a sealed certificate of record attached.

The fee for recording and certifying an assignment is \$1 up to 300 words; \$2 from 300 to 1,000 words; and another dollar for each additional thousand words or fraction thereof over 300 words.

After the assignment has been duly recorded, the assignee may substitute his name for that of the assignor in the copyright notice on the work assigned. Such substitution or transfer of ownership will be indexed upon request, at a cost of 10 cents for each work assigned.

FRAUDS

Classification—Actual and Constructive Frauds—Subject of Misrepresentation—Actionable Expressions—Consummation of Fraud—Concealment—Non-Disclosure—A General Rule—Other Causes for Action—Right to Rescind—Action for Damages—Presumption of the Law—Fraudulent Conveyance—Original Statute—Essential Features—The Property—Intention to Defraud—Bona Fide Purchaser—Garnishment of Property—False Impersonation and False Pretense—Cheats and False Symbols—Forgery and Counterfeiting—Larceny—Catching a Bargain—Frauds in Partnership—Conclusion.

XXVI

FRAUDS

FRAUD has been defined as a deception deliberately practised for the purpose of obtaining an unlawful or unfair advantage.

Many attempts have been made to formulate a more comprehensive definition of fraud, but all thus far given have been open to criticism. Indeed, it would be eminently unwise, particularly in legal practise, to be limited by a definition as to what might or might not constitute a fraud, in view of the fact that were a limit set, ingenuity of the unscrupulous would undoubtedly discover some means of evading the law. Then it is found that no two fraudulent transactions are exactly alike in all particulars, and the formulation of an exact definition applicable to all cases which may arise is practically impossible.

Under these circumstances the character of any transaction under investigation must be determined according to its own peculiar facts, and where precedents fail in determining any particular case, it is to a great extent left to the judgment of the judge sitting upon the case to render a decision.

Classification.—Attempts to classify frauds have met with a greater degree of success than attempts to define them, and the classification made by a former Lord Chancellor of England has been almost universally adopted.

In one class were included all frauds arising from facts or circumstances of imposition, as, for example, when positive representations were made by one of the parties to a sale or contract, knowing that the same were

false; or when, also with intent to deceive, material facts were concealed so that a false impression was given; or when false representations were made by a third party for the purpose of inducing the second to enter into a contract.

Frauds of the second class are such as are concerned with the subject and nature of the bargain itself. No misrepresentations or concealments may have been made, but yet the contract or bargain may be such as no honest and upright man would make, or no one in possession of his senses and not acting under a delusion would accept. This class also includes cases wherein one person taking advantage of the necessity or distress of another is able to force him into making an inequitable bargain. Under ordinary circumstances, it is expected that the parties to a contract will possess sufficient business acumen to protect their own interests, but in the case of persons under pressure, or ignorant persons without adequate legal protection, it devolves upon the person deriving benefit from the contract to show its fairness, should any question as to the same arise. Contracts between persons occupying the respective positions of borrower and lender, or mortgagor and mortgagee, are subjected to a rigid scrutiny when brought before a court. Invariably the courts have refused to enforce a contract whereby one person would suffer injustice without any corresponding loss being placed upon the other person concerned.

The third class introduces a new relationship, viz.: fiduciary or confidential, as that of guardian and ward, attorney and client, husband and wife, or parent and child, etc., and comprises such frauds as may be perpetrated by those who hold a position of trust or of protection over their clients.

The fourth class covers cases in which the persons defrauded are not a party to the agreement; as, for example, when an insolvent debtor conveys property to his wife or friends in order to defraud his creditors, or when an agreement is made with one creditor whereby he is to receive a greater proportionate amount than the others.

Actual and Constructive Frauds.—Frauds are also divided into two general classes: actual and constructive. Actual fraud is the result of a premeditated dishonesty, and implies a wilful act, performed for the purpose of unjustifiably depriving another of that to which he is rightfully entitled.

Constructive frauds do not take into consideration the honesty or dishonesty of the motive, but are concerned wholly with the actual circumstances in connection with the case. In fact, a person of absolute integrity might be instrumental in making agreements which, by reason of their tendency to deceive, would be considered as frauds and prohibited by law.

The frauds most easily classified are those wherein one person has made a positive misrepresentation as to some particular fact.

Subject of Misrepresentation.—As a general rule, the actual subject of the misrepresentation is immaterial. And since fraud cases are decided in a great many instances by precedent, brief mention will be made of the same. A point worthy of notice is that a false representation resulting in damage to another may furnish grounds for legal action, whether made in connection with a contract or not. Actions have been founded upon false statements made in reference to personal property, real property, and impersonal objects. Under the last head may be placed misrepresentations, made by any one regarding the solvency or credit of another or of himself, which result in a third person extending credit, with subsequent loss, to the person about whom the statements were made. A false statement to be actionable must be more than a mere expression of opinion, but a misrepresentation may be made by actions as well as words. As an instance of such actions, the case may be mentioned of a person at Oxford, England, who by donning the cap and gown of a student was able fraudulently to obtain goods on credit from tradesmen. Other instances of frauds of the same general character are the giving of checks, knowing there are no funds in the bank to

pay them; pouring oil upon land to give it a fertile appearance: "salting" a mine; packing inferior goods so as to lead the public to believe that they are of a superior brand; soliciting contributions while clothed in the distinctive garb of a charitable organization; and in brief any case involving an impersonation with intent to defraud. The daily newspapers are full of stories hinging upon the element of fraud, and it may safely be said that such cases far outnumber all other wrongs and misdemeanors.

Actionable Expressions.—There are cases, however, wherein what may appear to be a mere expression of opinion is actionable. For instance, one person sold cattle to another for which the buyer paid a certain amount, based upon their weight, as expressed in the form of an opinion by the vendor. When later it was discovered that the price and weight were excessive, and that the vendor was in possession of exact knowledge of the weight of the cattle at the time of the sale, the case was decided against him. A similar case was one in which one person sold another a piece of land, giving it as his opinion that the tract contained a certain number of acres in excess of the actual area, with which he was acquainted. This was also decided in favor of the buyer.

Consummation of Fraud.—In order that a fraud be consummated, the misrepresentation must be made in reference to some natural fact. Even false statements, made with a knowledge of their falsity and acted upon by the second party, furnish no cause for action unless they have a bearing on the business in hand. As an example of such may be mentioned false statements made by a real estate dealer regarding his social, political, and religious associations. It is rather difficult at times to decide whether a false representation has a direct bearing on the business or not, but as a general rule only such representations as are essential to the completion of a contract can be considered material. As, for example, stating an exaggerated amount as the rental on property

which it is desired to sell. The question, however, of deciding the character of a statement or representation is governed by facts, and is unaffected by the opinion in the mind of the one to whom it was made.

Concealment.—While the two parties to a contract are morally bound to inform each other of all the facts in their possession regarding the matters in hand, which can not be found out through ordinary observation, yet it can not be accounted a fraud if one of the parties fails to make known material facts which the second party has made no effort to discover. If, however, owing to the relationship between the parties, it is the legal or equitable duty of one of the parties to inform the other of all the facts in his possession, and he fails to do so, his silence alone will be considered a fraud. This relationship may be one of trust, it may be that of principal and agent, attorney and client, physician and patient, husband and wife, priest and parishioner, parent and child, guardian and ward, partner and partner.

Non-disclosure.—A distinction exists between mere non-disclosure of a fact and its concealment. In the first case, nothing whatever is said concerning the fact, but in order to conceal a fact, resort may be had to deliberate falsehood, or a part of the truth may be withheld so that a wrong impression is given, in which event it is considered fraud.

A fraud is the product of a false representation; and while its falsity, its bearing on the case, and the intent to deceive may all be proved, it is still necessary to show that the party to whom the representation was made acted upon it and suffered loss thereby, before he is entitled to redress or damages. In cases of this sort, an action can not be based upon fraud without damage, or damage without fraud, but only upon a combination of the two; and it is not enough merely that a person should be induced to perform certain actions: the actions must result in loss before a reasonable claim for redress can be made.

A General Rule.—As a general rule, in the purchase or exchange of property, a person is entitled to receive and is expected to pay for that which was designated in the bargain. If he is induced through misrepresentation to pay more or take less than agreed upon, he has a justifiable right to disregard the contract and sue for redress, notwithstanding the fact that he may have received full value for his money. On the other hand, a person can not enter an action on account of misrepresentations made regarding property taken by him as security for money loaned, unless he can show wherein he has suffered loss or that the actual value of the property is less than the amount loaned.

Other Causes for Action.—False statements regarding the financial standing of another, or of a person himself, are also sufficient ground for a suit, provided loss has been suffered by any one who extended credit on the strength of the misrepresentation.

In the business world, the right of a person to secure business by fair means in the face of competition is unassailable, but statements made about his competitors without any foundation in fact, for the purpose of profiting at their expense or injuring their business, are actionable as frauds if their object has been attained.

Representations resulting in the abrogation of, or failure to live up to, the terms of a contract, when not received through a legitimate channel and result in loss, are also a cause for action. Frauds are very frequently associated with the composition agreements between an insolvent debtor and his creditors, and in many cases it is regrettable that they can not be clearly proved against the perpetrators. It is a common occurrence for unscrupulous merchants when they find business on the wane to take the utmost advantage of their credit, and buy heavy supplies of stock, which are immediately disposed of to auction rooms for perhaps less than half their value in cash, or concealed. The money from this and other sources is distributed among relatives and friends as payment for imaginary debts, and when the inevitable



TRADE MARK
MULTIKOPY
Hawthorn
Keenoh
TRADE MARK



Kuyler's



Libbey
THE WORLD'S BEST

"Standard"

"Porsknit"
TRADE MARK

Everwear
TRADE MARK

HEINZ
57
VARIETIES

W. K. Kellogg



Peerless

LITHOLIN



JELL-O

RUBBERSET
TRADE MARK

B.V.D.

The Knabe



Campbell's

"A Kalamazoo"
Direct to You
TRADE MARK-REGISTERED



Some Well-known Commercial
Trade-Marks

failure ensues, the legitimate creditors may have to content themselves with a few cents on the dollar or nothing at all. Things would not be so bad did the criminality cease at this point, but in due course of time the bankrupt receives his discharge, and goes into business again under a different name, only to repeat the performance when it appears to be to his advantage.

It has sometimes been held that a contract between persons, one of whom was the victim of misrepresentations or concealments, is void, but according to the decisions rendered in the majority of cases, this view seems to be incorrect. It is admitted that a contract formed under such circumstances is voidable, but this lies wholly in the hands of the party to whom the misrepresentations were made, who may hold the other party of the contract if he so desires, but if he affirms the contract while cognizant of the fraud, he loses his opportunity to avail himself of this privilege. An important distinction exists between a mistake and a fraud in their effects upon contracts.

A contract entered into under fraudulent conditions may be valid; but a mistake, if of any consequence whatever, renders a contract absolutely void without being left to the option of either of the parties thereto.

Right to Rescind.—It is now an established fact that any person who has been induced to enter a contract by fraud may rescind the same at his discretion, subject, however, to certain limitations. He can thus avoid all liability under the contract, or he may bring an action for damages.

Among the limitations referred to may be mentioned the case where affirmation of the contract has been made while knowing the circumstances; or where the person possessing the right to rescind has delayed action for an unreasonable length of time, or has partially affirmed a contract. In order to be entitled to rescind a contract, the money, land, or other consideration must be returned, or at least an offer made to do so; and any depreciation in the value of the consideration from use or other cause,

previous to the discovery of the fraud, does not nullify the right to rescind. If the party to whom the offer to return the consideration is made refuses to accept it, the party making the offer is relieved from all liability attached to having the same in his possession, and is at liberty to recover by law what he has given in exchange, if the same is refused him. Other special limitations also exist.

Action for Damages.—If the property has been placed in the hands of another having knowledge of the fraudulent circumstances and who has not given a “valuable consideration” for it, it may be recovered by the original owner; but if it has passed to a bona-fide purchaser, the person defrauded, as a general rule, can only secure redress through an action for damages. The amount of the damages to which the victim of a fraud is entitled is equal to the loss which would be the natural consequences of the fraud. Under different circumstances exemplary or punitive damages may be awarded. The rule in brief is, that the defrauded person is entitled to sufficient compensation to reimburse him for the injury actually inflicted; and the promise to make the representations good on the part of the person who had made them in the first place does not relieve him of the liability for his actions. The ignorance or knowledge of the falsity of the representations made by the person has an important bearing in deciding the proper amount of damages to be paid. He can only be held liable for the loss or injury resulting from those actions or statements with the falsity of which he was acquainted, and then only for those which are of proximate occurrence. In a case where, by the exercise of ordinary diligence, a person might escape injury resulting from misrepresentations, but fails to do so, the law will not assist him in securing damages for an injury which he might easily have avoided. Neither will it take into consideration loss from a speculative source, unless the same can be clearly defined and ascertained. When a person’s rights have been invaded, but without causing any determinable loss, nominal damages are sometimes

awarded, and cases have been tried where damages of one cent have been awarded.

Exemplary or punitive damages may also be awarded as recompense for the injury resulting from fraud, when in the opinion of a jury there was an actual fraudulent intent.

Presumption of the Law.—The law relating to cases of fraud presumes, as in all other cases, that a man is innocent until he is proved guilty, and the duty of furnishing the proof of fraud falls upon the person making the allegation.

When it is a question of fact whether or not there has been fraud in a given case, the decision must come from a jury; but if the facts are admitted by the person under trial, and the question remains as to whether or not these acts constitute a fraud, such decision will be given by the court. The points upon which a jury is called upon to decide usually have reference to determining whether a statement is one of fact or opinion, whether a representation is material or immaterial, whether it was made knowingly and with fraudulent intent, or whether its character was such that the person to whom it was made had a right to rely upon it.

Fraudulent Conveyance.—Among the things for which our later civilization can be counted responsible are the many frauds in connection with the illegal conveyance of property from one to another for the purpose of depriving lawful creditors of their rights.

Under the old Roman law insolvency was punishable by death or slavery, and even in later years, according to the laws of England, a creditor might throw his debtor into prison and keep him there until the debt was paid. In consequence of these laws, the incentive to pay one's debts was infinitely greater than that for any other disposition of property. Under such conditions, debtors have been known to dispose of their property and flee beyond the jurisdiction of the law, to some haven where they might safely dictate terms to their creditors; but in

the majority of cases such a step was rendered impossible by the vigilance of the creditors.

With the passage of time the penalty of imprisonment for debt was abolished, and simultaneously the execution of fraudulent conveyances began. Thus we see an instance of steps made in the interest of humanity being taken advantage of by the unscrupulous at the expense of those to whom they are indebted. To such an extent has the practise grown among debtors in recent years that it is now the exception for a judgment to be collected by the ordinary process of execution. Even in the time of Queen Elizabeth, affairs had reached such a stage that it was found necessary to enact legislation for the protection of creditors in their rights, and the statute of Elizabeth, as the law was termed, has justly become famous. Authorities claim, however, that the rules and principles of the common law were sufficiently comprehensive to provide for all kinds of frauds and that the statute of Elizabeth merely declared and emphasized those already in existence.

Original Statute.—In the United States, while the laws bearing on the subject in each State may differ from each other and from the original statute in phraseology, the principles involved are practically identical. This statute runs as follows:

“This act declared, ordained, and enacted that all and every feoffment, gift, grant, alienation, etc., of lands, tenements, hereditaments, goods and chattels, etc., had or made with intent or purpose to delay, hinder, or defraud creditors and others of their just and lawful actions, suits, debts, accounts, damages, penalties, forfeitures, etc., shall be deemed and taken (only as against that person or persons, his or their heirs, successors, etc., whose actions, suits, etc., by such guileful, covetous, or fraudulent devices and practises, shall or might be in any way distributed, hindered, delayed, or defrauded) to be clearly and utterly void, frustrate, and of no effect; any pretense, color, feigned consideration, expressing of use, or any other matter or thing to the contrary notwithstanding.”

Essential Features.—In order to consummate a fraudulent disposition of property, three features are essential: a creditor to be defrauded; a debtor having the desire to defraud; and a disposition of property which, in the hands of the law, would have been applied toward satisfying the claim of the creditor.

The term "creditor" in this connection is of more extensive application than that usually ascribed to it. For example, a woman when married has a certain right to the property of her husband, by virtue of which her disposition is in reality that of a creditor.

In consequence, it has been decided that a man who signs away property previous to his marriage and without the knowledge of his prospective wife, for the purpose of defeating the interest she would acquire, is on a par with one who does the same thing previous to making an assignment. In the same way, any one having a claim for trespass or damages against another is virtually the creditor of the other; and persons convicted of criminal offenses, punishable by fines, etc., are in the position of debtors to the Government.

Several other cases in which the relationships are in reality that of creditor and debtor might be mentioned, but being of minor importance, are omitted.

The Property.—The property conveyed, in order to render the conveyance fraudulent, must be such as could have been employed for the satisfaction of the creditor's claims. If the property in question is exempted by law, or for any other reason is such as could not be applied to the liquidation of debts, no fraud attaches to its disposition. For example, one person may have a legal title to property which another owns in equity, as in his own name, but paying for it from his wife's private purse. Such property can not be called upon for payment of the husband's debts, and any conveyance of it is perfectly legal, provided the property has not been used (with the wife's consent) as a means of obtaining credit. In general, any kind of property may, if illegally conveyed to another, be recovered and devoted to satisfying the claims

of the creditors. There are, however, several exceptions of importance to the general rule.

In former years a married woman's earnings were the property of the husband and could be seized to satisfy the husband's debts, but at present statutory laws confirm the title of a married woman to her own property and place it beyond the risk of seizure.

The income of a minor child has been considered attachable. In a certain case a father, while solvent, promised his son a certain farm upon condition of his fulfilling certain requirements. The father in the meantime became insolvent. Attempts were made to seize the farm for the benefit of the creditors, but the son's claim was upheld by the court.

Intention to Defraud.—The intention to defraud is positive proof of the character of the conveyance, but if the conveyance should be fraudulent in only one respect the complete action is void so far as creditors are concerned.

If the property is sold for a valuable consideration, that is for an amount at least approximately equal to its actual value, the law will protect the purchaser; but if the amount received was but a trifle compared to the actual value, thus indicating the presence of fraud, or if the property was transferred by voluntary conveyance, that is without the receipt of any consideration whatever, the law may step in and seize such property, notwithstanding the fact that the party from whom it is taken may be absolutely innocent of any fraudulent intent.

Bona-fide Purchaser.—The right of a bona-fide purchaser to the possession of property is stronger than that of a creditor, and in the event of a debtor disposing of property by a bona-fide sale, the creditor must look to the proceeds of such sale for satisfaction of his claim. In order that a sale may be considered bona-fide, a price equal to a fair market value must be paid, and that before notice has been given of the condition of the affairs of

the bankrupt. A mere verbal promise to pay is not sufficient to protect the title of the purchaser ; but if a part of the purchase price has been paid, he will be protected in equity to that extent, but not to any greater extent on account of payments made subsequent to his having acquired a knowledge of conditions.

We have seen that a conveyance when proved to have been made with intent to defraud is void. It is equally void if made by an insolvent person, even if ignorant of his own financial condition, or when the giving away of such property would so deplete the estate that sufficient funds would not remain to pay the creditors.

Garnishment of Property.—In order to secure land or property, fraudulently conveyed to another by a debtor, for the benefit of creditors, a judgment may be obtained and the property levied upon, or garnishment proceedings may be instituted. Garnishment is an auxiliary action in aid of a judgment, and is for the purpose of obtaining satisfaction of the judgment. The garnisher is the one instituting the action; the garnishee, the one in possession of the property; and garnishment, the proceedings. Garnishment proceedings are of purely statutory origin. In some places a hotel-keeper is empowered to garnishee the wages of his guests for their board, and the United States Government can employ the same means in the satisfaction of duties on imports. When this means of obtaining satisfaction is employed, an affidavit must first be made and filed by the plaintiff, his agent, or attorney, before a writ of garnishment is issued. It should contain a statement of the plaintiff's claim and the grounds upon which the writ is issued, and in some cases it is necessary to give bond to indemnify the garnishee against possible damage. The garnishee is notified to the effect that the property in his hands has been attached, and in some jurisdictions he is required to appear in court and submit to an examination in regard to the same.

The actual forms and methods are governed by the statutes of each State. The time within which a trans-

fer of property may be considered a fraudulent act in bankruptcy also varies, but is usually between two and six months.

False Impersonation and False Pretense.—Two fraudulent proceedings, resembling each other in some respects, are false personation and false pretense.

In the first some particular person must be impersonated, but if the impression is given that the person merely belongs to some particular class, order, or profession, the offense is classed as a false pretense.

In some cases, personating an officer is considered a case of false impersonation and is punished as such. The personation of a voter has also been made a crime by statute, and is considered to have been committed when the person makes the offer to vote, whether he succeeds in voting or not.

Obtaining property by false personation is different from larceny, although the results may be the same. In the first case, it is the intention of the owner to convey title to the property, but this element is lacking in the case of larceny.

Cheats and False Symbols.—Another variety of frauds is known as cheats, and is classified as public and private cheats. A public cheat is such as might affect the course of justice or the public at large, although having its origin in a transaction between private persons. Fraudulent actions by public officials and the selling of unwholesome provisions are examples of offenses classed as public cheats. Private cheats, as the name would imply, are such as might occur in transactions between individuals, and are usually effected by the use of false tokens or symbols, forgery, and conspiracy.

False symbols and tokens include false weights and measures, counterfeit trade-marks, etc.

Forgery and Counterfeiting.—A forgery is a false pretense, but many false pretenses may be effected in writing, which are not necessarily forgeries. Forgery is an of-

fense quite frequently met with in business life. The preparation of spurious documents, or the signing of another's name wrongfully to documents, particularly to checks, is its most frequent form of occurrence. Closely allied to forgery is the practise of check raising, which consists in changing the words and figures denoting the amount of money on a check to a higher amount. While criminals exist and checks are in circulation, attempts will be made to defraud by this means, although various measures have been employed to prevent such actions, some of which have been very successful.

Still another offense somewhat similar to the above is the counterfeiting of money. This, however, has been made very difficult by the improvements that have been made by the Government in the art of making money, improvements which have been impossible for the counterfeiter to imitate.

Larceny.—Larceny, which may be “grand” or “petit,” according to the value of the property involved, consists in wrongfully appropriating the property of others to one's own use, the same being obtained without the knowledge or consent of the owner. The distinction between larceny and false pretense has already been noted. Examples of false pretense are: Where an agent collects a greater amount than an account actually calls for and keeps the difference, or obtains money through pretending to be the agent of another. Examples of larceny are: Where one person collects money for another and keeps it; where an amount was put up by a clerk as a guaranty and was appropriated by the employer; or where a person presents a bill in payment of a debt and is refused the proper change.

Catching a Bargain.—Another proceeding which may be fraudulent in its character is what is known as “catching a bargain,” or merely “catching bargain.” It is usually effected by an unconscionable agreement of some sort, e. g., sale, loan, mortgage, annuity, etc., entered into with some one on the strength of his future inheritance

or legacy. Quite frequently if the consideration can be proved to be inadequate, the contract may be voided, but not invariably so, if every other feature is lawful.

It is said that where there is no relationship of trust or confidence among persons, a misrepresentation regarding the law does not constitute a fraud, and that a contract entered into by any one when influenced by the statements of another regarding the law can not be broken, notwithstanding the fact that the statements may have been false. Both parties, however, are presumed to have equal knowledge. This rule applies to misrepresentations made regarding the legal liability of subscribers to the stock of a corporation, false representations of the powers of a corporation granted by its charter, false representations by a sheriff regarding his returns, or an execution, etc., and false representations made by the officers or stockholders of a corporation to induce a person to sell his holding or buy stock in the concern.

Frauds in Partnership.—In closing up a partnership business it is not uncommon to find traces of fraud in the disposition of the partnership property. It is illegal for one partner to liquidate a personal debt from the firm property without the consent and knowledge of his partners. The conveyance can be set aside by the remaining partners on its becoming known; although such a proceeding would be lawful if the firm were solvent, and the other partners raised no objection. As to whether such a step is legal when a firm is in business, but is really insolvent, authorities differ.

Drawing money from a concern before assignment, unless restricted by law, does not necessarily invalidate an assignment. Such an action is, however, sufficient to raise suspicion of fraud, and taken in conjunction with other circumstances might justify reaching the conclusion that the assignment was made for the purpose of defrauding the creditors.

Concealing, withholding, or removing property also tends to show fraud, and in one case an assignment was set aside owing to the fact that the assignor had made a

valuable gift to his wife just before assignment. Keeping out such property as is exempt from execution or attachment does not invalidate an assignment.

In Conclusion.—In the foregoing the attempt has been made to touch lightly on several of the more common and pernicious frauds which are, unfortunately, met with in business. To treat such a subject in its fullest detail is manifestly impossible in a work of this sort; and in closing it may be well to quote the words of an English writer, Mr. J. Keethy: "Fraud, if not quite as old as the hills, dates back pretty well to the habitation of this earth by human beings. As to how long its nefarious presence is likely to remain with us, one does not care to prophesy. So long as private property and covetousness exist, it is most likely that frauds will be coexistent. When the land of Utopian dreams is reached, and no one can claim the right to any particular thing as against the right of any other person, then, may be, the incentive to fraud will disappear."

XXVII.

PROFITS AND RESERVE FUNDS

I. WHAT CONSTITUTES PROFITS

Profits Earned and Profits Realized—Smallness and Variability of Profits—Definite Factors—Different Classes—How Estimated in Trade—In Life Insurance Companies—Profits between Departments—Transfer of Fixed Assets—Departments as Virtually Separate Concerns—The Profits of a Corporation.

2. THE DIVISION OF PROFITS

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3. RESERVE FUNDS

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XXVII

PROFITS AND RESERVE FUNDS

I. WHAT CONSTITUTES PROFITS

A "PROFIT" may be freely defined as the gain accruing from the conduct of a business. If the price for which goods are sold is greater than their cost to procure, handle and sell, the difference is a gain, or profit. If the selling price is less than this cost, however, the difference is a loss.

Profits Earned and Profits Realized.—A very clear distinction must be made at the outset between "profits earned" and "profits realized." The word "earn" means to reap, and is derived from an ancient root meaning *to plow*. There is no suggestion of money in the word, which clearly implies that corn once harvested must be considered as earnings, or something gained by labor. And the principle of including, as profits, earnings that have not been received in the form of money has for centuries been accepted in trade. The division of profits (as dividends), however, must result only when the earnings have been made tangible, if not actually rendered into cash in hand.

As to the fundamental meaning of profits, the gross profit earned in a trading concern is the amount by which the proceeds of trading—whether realized in cash or not—exceed the cost of acquiring or manufacturing the articles dealt in. The net profit is the amount by which the aforesaid gross profit exceeds all expenses of establishment and of realizing the gross profit. The fact that goods have been sold to a customer who (when the accounts are prepared) is known to be insolvent does not

affect the gross profit earned, but of course an adequate provision for loss must be made before a true statement of net profit can be arrived at.

It is generally held impossible to lay down rules that will always enable one to ascertain what profit has been earned in any particular case. Profit can seldom be more than estimated, seldom figured as an absolute sum, for liabilities may exist which are not known. An illustration in point would be the depreciation of mines. One may obtain the best expert opinion as to the resources of a mine, and before the year is out a "fault" may be discovered which will at once show that these opinions are valueless. In mining, therefore, no figure can be accurately written off for depreciation. In many mining and other concerns profit is accordingly estimated, subject to this unknown contingency. It should, of course, be understood in such cases, by shareholders and creditors, that the concern does not charge any depreciation of its permanent assets against revenue.

Smallness and Variability of Profits.—Considered in the full sense of the word, profits will be found comparatively small in most individual business concerns, and in many they will be found not to exist at all. The average business man may be considered successful if his returns consist merely of a fair interest on his capital invested and a moderate compensation, serving as salary, for his own supervision of the business. A small farmer's profits are unlikely to exist at all. At the end of the year, after he has paid for the support of his family and all the expenses of the farm and allowed a moderate interest on the value of his farm, how much is he actually able to place in the bank? In farming the item of depreciation is of almost as great importance as in manufacturing.

One of the important matters to be considered in regard to profits is their great variability, in all types of business, from year to year. Profits depend upon variable factors—price of raw materials, wages, volume of sales, and price obtainable for products. All of these factors

are constantly changing and highly sensitive to fluctuations of every kind.

Definite Factors.—There are certain definite factors that can be assigned as the sources of profits. Chief among these is superior efficiency. The man who knows his business best, buys the best machinery at any cost, surrounds himself with the best men and binds them to him with liberal salaries and mutual respect—this man is going to have the most successful business.

A second source of profit is the presence of a great or unusual demand for the product in question. This occurs perhaps as a result of advertising, in which case the demand has been created by an association of ideas; it occurs frequently in the case of necessities, as the result of strikes, short crops, etc., when a normal demand is suddenly turned aside into unaccustomed channels, which then become glutted, resulting in abnormal sales for a short period.

A third source of profit is appreciation in the value of property. This applies to real estate, mines, etc. Many enormous fortunes have resulted from foresight in buying up neglected or uncultivated lands, which ultimately became populous or otherwise highly profitable.

A fourth fruitful source of profits is monopoly. There is the monopoly of industrial combinations ("trusts"), the monopoly of great production, and the monopoly of ability, in which the business man surrounds himself with the best brains in his line of business. There is the very common and fruitful monopoly by law in a patent, or an exclusive franchise (as in street railways); and there is the monopoly of special brands of goods, protected by patented methods of manufacture and furthered by advertising.

In general, regularity of profits is proportionate with the degree to which products are necessities, and grow more and more irregular as they tend to be luxuries. This is observable in the very slight fluctuation, even in times of marked financial depression, of such an industry as the street railway.

Different Classes.—Profits may be divided into five classes: (1) Those from transactions finished, actually received in cash; (2) those from transactions finished, not yet received in cash; (3) those on transactions unfinished, either received or not received in cash; (4) those not arising strictly as a result of the nature of the business; (5) those resulting from an increase (by estimation) in the value of assets, whether fixed or floating.

If all the transactions involved during a given period have been completed, it is a comparatively easy matter to state the profits earned. But where the transactions are numerous and in an incomplete state it is practically impossible. Estimates have to be made, based upon knowledge of the past and the probable results of the future. In ascertaining profits, only those transactions can safely be considered which have been completed, that is, in which the contract is complete and the ownership of the goods has passed from the seller to the buyer. Even goods in process of sale which appear to be sold must only be brought into account at cost price as stock, and in goods being sold by the instalment system only those sums that have actually accrued from the current assessment.

How Estimated in Trade.—In trading concerns there is always a certain percentage of gross profit which is depended upon and expected as normal. But the actual as well as the nominal gross profit has to be estimated and should be kept at all times in such shape that it can be easily ascertained.

The stock account may, for example, be credited with the sales, after deducting from it the gross profit instead of debiting the gross profit and crediting the sales. The balance shown will represent the stock in hand; and if any inaccuracy is found in this estimate at the periodical stock-taking, the amount of the inaccuracy will be placed against the nominal profit and the actual profit will result. Thus, by means of a discrepancy between the estimated and ascertained stock in hand, any difference in actual and nominal gross profits is brought to light. In trade,

all percentages of gross profits are based not upon the cost price but upon the selling price of goods.

In Life-Insurance Companies.—The profits of a life-insurance company are not ascertained annually, as in most kinds of business, but at rarer intervals when what is known as the "Valuation Balance Sheet" is prepared. An actuarial valuation is then made of the present value of the liability under all policies in force; this figure being the difference between the present value of the nominal amounts of the various policies, bearing in mind the expectation of life in each case and the present value of the premiums, when all expenses are deducted, which are anticipated during the remainder of the time that the policies continue in force. The amount by which the funds at present in hand exceed the present value of the liabilities, as so ascertained, is treated as profit during the current period. This amounts to keeping books by single entry.

Profits Between Departments.—How far is it permissible to treat as the profits of an undertaking as a whole the profits charged by one department to another? If a manufactured commodity has to pass, before it is completed, through three distinct processes and accordingly through three distinct departments, the only practical method of bookkeeping will be one that makes each department, as it passes the commodity on to the next, charge it to that next department at such a price as will enable it to take one credit for profit on the work it has performed.

This is necessary in order to close the books on any given product. As between the several departments, this procedure is just enough and certainly convenient, but from the standpoint of the house as a whole, it has, of course, the effect of taking credit for profit on work done before that profit is actually realized. This objection is, however, limited to the amount of unfinished or unsold stock on hand. And the unfinished goods are at no time valued for stock-taking purposes at a greater price than

would have to be paid for them at open sale in the outside market.

The system must, however, be watched with great care, for overproduction in any one department would lock up the working capital in assets not immediately realizable. Adverse fluctuations in the outside market must be closely followed, and, if the manufacturing process be such a long one that a considerable time elapses between the manufacture and the sale and the receipt of the purchase money in cash, a corresponding interval must elapse between the date when the various interdepartmental profits have been earned and the date when they will be available for distribution, and thus in such cases it would be very unwise to divide profits so closely as to allow no margin.

Transfer of Fixed Assets.—Where fixed assets are concerned the problem changes somewhat. Here we are dealing with the transfer of tools, machines, etc., manufactured by one department for the use of another. As they are articles which are not intended to be sold again, and consequently have no profits to be realized in the outside market, the question is, whether it is legitimate to treat as profits at all an assumed difference between the cost price and the intrinsic value of permanent assets. It may be argued that if the purchasing department had got its work done outside, the manufacturing department could have been doing work for outside customers and would have been entitled to take credit for whatever profit might have been realized upon this work; and so, if its time is taken up in supplying the needs of some other department, it ought to be compensated for the loss sustained in being debarred from doing profitable outside work. But again the objection might be that nothing beyond actual cost can be legitimately treated as capital expenditure, and that accordingly no fixed assets ought to appear in the books at a figure exceeding cost price, merely because the undertaking is in the fortunate position of having been able to keep that cost price exceptionally low.

Departments as Virtually Separate Concerns.—The importance of this question is evident in cases where an enterprise consists of distinct businesses, as for example, where a wholesale manufacturer has his own retail stores. In such cases it is plain that the manager of the individual department or branch must receive due credit for the value of all work done by his department. How far the ultimate question of profit is involved depends chiefly on the question of how far the division of the undertaking as a whole into departments is a real division actually existing, in fact, and how far it is merely in the nature of a subdivision, artificially introduced into the bookkeeping and organization in order to have the business more conveniently administered.

The Profits of a Corporation.—The consideration of profits in relation to corporations involves a consideration of the limitations placed by law or by true accounting principles upon their division in dividends. For corporations are subject to special restrictions exactly as they have special privileges, and one of these restrictions is that there must be a definite fixed capital stock upon which dividends are declared out of the profits of the enterprise. Dividends are to be paid only out of profits arising from the business of the corporation; capital and fixed assets must be maintained in efficiency. Where a fixed asset is sold, however, and there is no depreciation on other assets to be made up for, a dividend on profits resulting from the sale is permissible.

In calculating profits, the fixed capital may be valued at the price actually paid for it, though it could only be sold at a loss at the time of the calculation. The requirement is that all of the capital originally subscribed by the stockholders be kept intact in the business and that none of it shall be taken out and given back to them, under the guise of dividends. Dividends can properly be paid only out of the surplus profits which arise from the employment of the capital toward those specific ends for which the corporation was formed.

The changes in the actual value of capital assets are

often so indefinite, intangible, and remote that they can not fairly be charged directly against profits; and therefore a liberal reserve fund and provision for depreciation should be maintained. All waste, of either fixed or floating assets, must be made good out of profits gained.

2. THE DIVISION OF PROFITS

A distinction has to be made between the idea of net profit and of profit safely divisible, because, unless there is an abundant working capital, it is most imprudent to draw profits out of the business before they have been actually realized in cash. Unless it appears from the balance sheet that, after the withdrawal of the alleged profits, there would still remain enough liquid assets available to meet the ordinary requirements of the business, the profits have not been realized, or else they have been applied as working capital and can not be distributed without strain upon the business.

There is, of course, a broad distinction between distributing profits and crediting them to the profit and loss account. Profits ought always to be recorded as profits, inasmuch as the accounts of a company ought to record its position accurately. In transactions where assets are sunk for a considerable time and can not be called in quickly, the liability to loss by way of bad debts is great; therefore corresponding prudence should be exercised and liberal funds should be placed in reserve before any dividends are declared out of profits.

Divisibility of Profits.—From the business point of view the first requisites for defining divisible profits are: (1) That they shall be profits arising under such circumstances that their recurrence may reasonably be expected in future years under normal circumstances. (2) That a systematic division of profits so computed may, so far as can be foreseen, be regularly maintained, and in particular that large demands for renewals, etc., against which no provision has been built up, will not absorb the profits of any subsequent years. (3) That adequate

provision be made, and charged up against successive years upon a fair basis, for all renewals that will be necessary for the conduct of the business.

As profit is that which capital produces beyond its own value and after all expenses are paid, true profits can not be shown unless the capital which has earned the profit remains intact. Dividends can not be made on a mere expectation or hope of profits; nor can contracts entered into by a corporation for future deliveries of a product not yet made by it, from raw materials not yet purchased, be taken as assets in figuring such net profits as are necessary for a dividend. Of course, the question of what are divisible profits is a very elastic one, for very often there will be actual net profits sufficient for a dividend or for distribution among the partners of a firm when the safety or welfare of the business requires or suggests that profits ought to be returned to it and not divided at all; in which case the profits can hardly be called profits safely divisible.

Profit-Sharing.—The profit-sharing system is one in which employees receive in addition to their wages a certain percentage of the profits of the business. Of the various methods of profit-sharing the following may be mentioned: (1) An annual or periodical direct distribution in cash out of the total net profits or of the profits above a certain amount, determined by the proportion of each man's contribution in labor to the total amount of the labor done; (2) an opportunity for the employees to subscribe on easy terms to the stock of the company; (3) an extra wage paid over to a provident fund for the benefit of each participating workman, in cases of sickness, old age, or death.

Of these, the first in some form contains the essential theory of profit-sharing, and upon it fall the praise and blame which have greeted the idea. The economic purpose of it is to increase the efficiency of the employee by enlisting his interest in the increase of profits. And, where special efforts, or more than ordinary care, is called for, such services have to be recognized by extra emoluments.

Disadvantages.—The disadvantages of profit-sharing appear to be somewhat as follows: The majority of workmen can not look ahead to the end of the year and see in the year's results any connection with their daily work, especially where the total profits result from the work of a great number of hands, not one of whom appears to count individually either one way or the other; any effect of efficiency would be apt to result rather from some slight increase in good feeling toward the employer who shared his profits. But unfortunately when the precedent is once set the custom has to continue to retain this good feeling undiminished. In years when there are no profits or less than usual, the workman is not able to comprehend the causes, often very subtle and indirect, which have produced this result. He will therefore become additionally dissatisfied. This, too, may result from profit-sharing even where there are good profits to divide, inasmuch as the workman has no means of knowing whether the division is equitable and is apt to be of the opinion that the firm is always making immense profits. The idea is often considered unfair to the employer because the sharing is an out-and-out gift which is not earned at all in the proper sense, the profits of a concern being due to many causes besides the efficiency of the workers employed; and, moreover, the worker is not expected to share in the same proportion in the losses which in some years take the place of the profits. Just as it is unfair to the employer so it is often considered unfair to the employee, because when the management blunders and losses ensue he is disappointed in his expectations; and such a blunder may destroy in a moment more profits than could result from a practical increase in efficiency of an entire force during a whole year. Other objections which have been raised against profit-sharing are: That there is great danger of crippling the authority of the master; that discontent is produced by the seemingly disproportionately large amount of profits awarded to commercial intelligence and business management; that it will overstimulate the workmen to exert themselves to excess; that in bad times

the antagonism between employer and employee is increased by imputations of incompetence. These latter objections seem to be superficial.

One other point, as to the often reasonable objection to the public disclosure of profits to the employees. This could be overcome if the apportionment were placed without condition in the hands of two outside public accountants, one nominated by the proprietors, the other by the employees.

Advantages.—On the other hand, employers whose experience with profit-sharing has been an increase in profits sufficient to justify the idea, attribute the result to the following sources: The general quality of the work turned out is improved; the men are more careful and there is much less waste of material; there is less need of superintendence as the workmen keep a watchful eye upon one another; the stability of the personnel is greatly increased, with corresponding immunity from strikes; the workmen are ready to aid the management with suggestions for improved methods, and the tone of the whole business is improved.

Statistics.—There were estimated in 1909 to be over a hundred examples of profit-sharing in France; ninety-six elsewhere on the continent of Europe, forty-seven being in Germany; ninety-five in Great Britain, and twenty-three in the United States. The idea was first scientifically introduced by Leclaire, 1842, into France, where it has met with greater success than elsewhere and is most enthusiastically believed in. One of the best examples in France is the house of Godin, iron-founders, of Guise. For the rules of their society the workers are divided into four classes, according to seniority and merit: (1) The first-class members or partners, who receive a double share of profits. (2) The associates, who receive a share and a half of profits. (3) The participants, who receive one share in profits calculated upon the amount of their wages. (4) The helpers or auxiliaries (including the new hands and the floating

element, those who come and go), who benefit to the extent of insurance against illness and accidents and, in case of need, a pension.

A worker able to read and write and of good behavior may become a first-class member after connection with the society and residence in its buildings for five years. An equally liberal provision prevails throughout the ranks. The charges upon profits before any dividends are distributed are as follows: depreciation (buildings and materials); the insurance funds; the expenses of education; and the interest payable to owners of shares. The remainder, considered the net profit, is divided thus: Seventy-five per cent as dividend upon the wages of labor and the interest of capital, and twenty-five per cent as the reward of ability. "In this way," they say, "the partnership of capital, labor, and ability is realized."

Profit Insurance.—A recent and very valuable development of the insurance principle has been the insurance against losses caused indirectly through fire, explosion and the like, namely, losses to income and profits. It is a logical expansion of the practise upon which rent has been insured and is in line with the regular broadening of insurance away from its old practise of replacing or paying the value of tangible assets alone. For, of course, fire insurance, useful as it is, so long as the insurance is limited strictly to tangible assets and to rent, can not come anywhere near indemnifying the insured against all the losses direct and consequential that follow upon a fire.

The purpose of profit insurance is to indemnify the insured against loss of profit owing to the dislocation of business that necessarily follows upon fire or serious accident. Thus if the insured is to be indemnified against these losses for six months following the date of accident, the rate of premium is the same as the ordinary fire insurance premium. A period of six months is generally considered ample for all practical purposes, but, if desired, immunity for nine or twelve months may be purchased at a somewhat higher premium rate. The claims are assessed by accountants.

3. RESERVE FUNDS

Amounts set aside from profits to meet contingencies are termed "reserve funds." Although special reserve funds may be created for the purpose of providing for special contingencies, it may be taken as an axiom that no sum which is not set aside *from profits* can properly be called a reserve fund. Nevertheless, under the heading of "reserve" all sorts of items are frequently included which under no possible circumstances can be considered to have been set aside out of profits. This, perhaps, raises the somewhat large question as to what are actual profits; but it must at least be admitted that the term "reserve fund" is by no means applicable to all the classes following, although the title "reserve account" might properly be used in connection with each.

Classification.—The term is applied to each of these:

(a) A sum set aside to meet depreciation of property, and to provide for its future renewal. This is a charge against profits, rather than a sum set aside out of profits.

(b) A sum set aside for the purpose of equalizing the charge against profit and loss for repairs and replacement of machinery, etc. This, also, would appear to be a charge against profits.

(c) A reserve to provide for loss upon bad debts or depreciation of investments would likewise appear to be a charge against profits, unless, indeed, the amount so set aside was more ample than the circumstances of the case necessitated; and in this case it would probably be a better course to charge against profits what might be considered a fair reserve for loss, and to accumulate any further reserve that might be thought prudent in the form of a reserve fund, pure and simple.

(d) Investment fluctuation account. This is an item which, unless further explained, should never appear upon the face of a balance-sheet, and that for the simple reason that its meaning is by no means clear. It may mean that investments have been revalued at a higher figure than

cost price, and the proceeds carried to this account rather than to the credit of profit and loss or a reserve account; or, on the other hand, it may mean that the investments are stated in the balance-sheet at a higher figure than their actual value, and that the amount of the investment fluctuation account is an amount set aside in anticipation of future loss. The former is a perfectly legitimate form of a special reserve account; the proper place for the latter (which is, in fact, merely a depreciation account) appears to be in reduction of the stated value of the assets.

(e) Sinking fund, or an amount set aside (and specifically invested) for the purpose of meeting a future loss upon redemption of bonds issued at a discount, renewal of leases, etc.

(f) Compulsory sinking fund for the redemption or extinguishment of bonds, set aside in accordance with the provision of the mortgage. It represents money taken out and set apart for a specific object. It is created and maintained for the purpose of meeting the principal of bond or mortgage debts at maturity by laying aside certain sums annually for that purpose. At regular intervals, the money is taken from the general cash, and

1. Invested in securities that are readily marketable,
2. Placed on special deposit in a bank, or
3. Handed over to the trustee for the bondholders.

The sums so taken out accumulate by yearly additions and compound interest, until the maturity of the debt against which the sinking fund was set aside.

Sinking Funds not Charges.—Sinking funds are not charges against profits, but appropriations of profits, that is to say, a certain amount which might have been distributed among the shareholders is retained, so that in the same degree that the asset "Cash" is reduced on paying off the liability to the bondholders, there may be a corresponding restoration of cash out of profits, and the concern is not crippled on account of lack of working capital.

Some difference of opinion exists as to the proper

treatment of the amounts thus raised, and the opinion of Mr. A. Lowes Dickinson is of interest in this connection: "Sinking funds or debt extinguishment funds are not in theory a charge against profit and loss, for the reason that they do not represent a loss of expense, but the extinction of an existing liability. Inasmuch, however, as in most cases the only source out of which such redemption fund can be provided is the surplus earnings, it is usual to insert a provision in trust deeds that the sinking fund is to be provided out of the profits of the year. The discharge of liabilities involves either a corresponding reduction in assets or the accumulation of other liabilities or surplus. A reduction in current assets or the accumulation of other liabilities as a substitute for bonded indebtedness is clearly undesirable, and it is therefore necessary that the amount applied each year to sinking fund purposes should be transferred from profit and loss either to a special reserve fund or in reduction of some fixed asset account by way of provision for depreciation or otherwise. It must, however, be remembered that such provision for depreciation will be to that extent represented by capital instead of current assets, and while there is no theoretical objection to this, if the depreciation fund is sufficiently large, the latter necessarily ceases to be available in cash for one of its principal purposes, viz., the renewal of various capital assets from time to time. If, however, part of the fixed assets are of a wasting character, the sinking fund may be quite safely applied in reduction thereof, or it may with equal propriety be applied in reduction of good-will or patents. The safest way, undoubtedly, therefore in every case, is to charge the sinking fund instalment to profit and loss each year, and either credit it to a special sinking fund reserve or apply it as depreciation of some fixed asset for the renewal of which no cash expenditure will be required in the future."

The above, no doubt, is sound reasoning, and is certainly based on conservative lines. At the same time it sometimes happens that some companies, having made ample provision for depreciation, etc., do not consider it

necessary to treat the payments to sinking fund as a charge against profit and loss, but simply debit "Sinking Fund" with the cash payments to the trustees. In these cases where there is no provision in the trust deed that the sinking fund shall be provided for out of profits, there is no necessity to charge the amount thereof against profit and loss, and the charge may be provided for by a fresh issue of notes or capital stock.

Trustees not Directly Accountable.—As a rule, the trustees are not directly accountable to the company for their disposition of the cash which they receive, and can make such investments as they choose, subject in certain cases to restrictions requiring them to first purchase bonds of the same company, provided, of course, that they may be obtainable.

It seldom happens that these compulsory payments correspond in amount with proper depreciation, particularly where the sinking fund is fixed on a sliding scale, and it would not seem to be convenient to attempt to offset one by the other; nor, on the other hand, for the reasons urged above, does it seem equitable to compel a company to charge off both depreciation and sinking fund instalments.

In view of the fact that whenever sinking fund charges to profit and loss are in addition to ample charges for depreciation, probable losses on bad debts, etc., they really represent undivided profits or surplus which will revert to surplus or profit and loss account after the specific purpose for which they have been temporarily set aside (i. e., the redemption of the bonds at maturity) has been fulfilled, it appears that the correct way to state the sinking fund in the balance-sheet is as a separate section of the surplus or undivided profits, and not to include it among the actual liabilities.

Life-Insurance Reserve.—The "reserve" of a life-insurance company is a fund set aside out of the surplus premiums paid by the assured in the earlier years of their insurance to meet the deficiency of such premiums, to

cover the increased risk of later years when the expectation of life is shorter, and, unless they are separately stated, to provide for "deferred dividends." These are in reality actually allocated to the assured each year, but are not payable until the expiration of the full term of the policy. To a very large extent the reserves of life-insurance companies are "premiums paid in advance," rather than "accumulated profits."

Conclusion.—Finally there can be no doubt that it is improper to state as a reserve fund any sum which has not been actually set aside, out of profits, *solely* for the purpose of providing against unforeseen contingencies.

It might be added that the word "fund" is, in many cases, used in the same sense as the words "fund account." Considerable discussion of this question has taken place recently, it being contended by some that a "fund" can only be an asset, the word itself indicating something which is tangible. The discussion, therefore, hinges largely on the interpretation of the meaning of the word, and it is hoped that there will very soon be uniformity of opinion on the subject. At present, however, most large corporations use the former word.

The numerous failures that occurred during the year 1907, and, in fact, many failures of more recent date, show that the mere existence of large reserve accounts does not in itself suffice to ward off disaster, and hence many unfortunate stockholders have bitterly stated that these paper reserves were "fictitious," and there is much truth in their contention. Reserve funds should be actually invested in securities outside the business itself, and the balance-sheet should show them properly "earmarked."



Addressing Machine

These machines are now in general use in large offices. They may be operated either by treadle or by motor, and the cards or stencils are returned automatically to their proper places in the files. (See page 280.)

XXVIII

INSOLVENCY, BANKRUPTCY, AND RECEIVERSHIPS

Causes of Insolvency—Remedies in the Event of Insolvency—
Bankruptcy—Who may Become Bankrupt—Receiverships—How
Appointed—Duties of a Receiver—Order of Payment by
Receivers—Reorganizations—Cash Requirements—Fixed Charges
—Voting Trusts.

XXVIII

INSOLVENCY, BANKRUPTCY, AND RECEIVERSHIPS

THE definition of insolvency given in the National Bankruptcy Act is substantially as follows: Insolvency exists where the value of an individual's, firm's or corporation's assets is less than the aggregate of its debts. Prominent legal authorities contend, however, that the definition is without precedence in law.

In the discussion of this unfortunate but important phase of business we have closely followed an able analysis of this and the allied subjects, receiverships and reorganizations, from the pen of Mr. H. R. Swartz.

Causes of Insolvency.—Insolvency may exist from the inception of a business owing to the value of assets purchased or acquired being overestimated. In such cases unless there is a rapid increase in the value of the assets, bankruptcy proceedings, a receivership or a reorganization is inevitable. Insolvency may also be caused by a considerable decline in the value of the assets after they have been acquired, on account of damage by fire, cyclone, etc., not fully covered by insurance and the consequent loss of business.

Bad management, mostly the result of incompetence and inexperience, is the cause of a large percentage of business concerns becoming insolvent. The lack of a proper cost system leads to selling below cost. Such a condition could exist for some time and, while a concern's business might increase, the business would actually be conducted at a loss and its capital would gradually be used up.

Lack of earning power is sometimes the cause of failure. For example, a concern may purchase valuable real estate with borrowed money secured by the real estate itself and commence a business the volume and margin of which is small, so that the surplus over and above the cost of conducting the business would not be sufficient to meet the interest on the borrowed money.

There are many other causes of insolvency, such as fraud, theft, failure of others, and lack of working capital. It has been declared by eminent legal authorities that insolvency exists when the cash assets are insufficient to meet maturing obligations, although the aggregate of the value of the assets of the business exceed its liabilities to a considerable amount. It is a fact well recognized by all that while the value of the unsalable assets would be fair in such cases, as a going business, nevertheless if the business were liquidated the value of such assets would shrink to a considerable extent. One of the most recent notable cases coming within this class was that of the Westinghouse Electric & Manufacturing Company.

Remedies in the Event of Insolvency.—The remedy for insolvency is bankruptcy, the appointment of a receiver, or a reorganization. The exact remedy is sometimes a matter of considerable doubt; in some instances bankruptcy is unquestionably the one to be applied, particularly so in the case of a small business concern. In cases of larger business enterprises, there are a number of conditions that must be taken into consideration and govern as to whether a receiver should be appointed, or other plans adopted.

It is unquestionably a fact that if all the parties in interest can agree upon a plan of reorganization it is preferable to the appointment of a receiver, for the reason that such an appointment is the cause of the loss of confidence in the business concern by the public and business world to a greater or lesser degree.

Furthermore, the fees and expenses of receivers, particularly in the federal courts, are notoriously excessive,

and in some cases have absorbed all of the property of the bankrupt. Then, too, the average receiver is incompetent and more interested in his fees than in the creditors. In England public accountants are appointed receivers and trustees, and the fees charged and results obtained compare so much more favorably with the practise in the United States that business men, who are the ones who pay the bill, should unanimously approve the adoption of such a system.

Bankruptcy.—The Constitution of the United States confers upon Congress the sole authority to establish a uniform bankruptcy law. Bankruptcy may be voluntary or involuntary. It may be asked for by an insolvent individual or partnership in order to obtain a discharge from his or its debts; or it may be asked for by creditors whose claims are unsatisfied in order to obtain an equitable division of the property of the insolvent person or concern.

The Bankruptcy Act provides that a corporation can not become a voluntary bankrupt, but those engaged in manufacturing, printing, mining or in a mercantile business, owing debts to the amount of one thousand dollars or more, may be adjudged involuntary bankrupts.

Who May Become Bankrupts.—The following persons or concerns are recognized by law as coming under the provisions of the Bankruptcy Act:

(a) Any person, partnership or corporation except a municipal, railroad, insurance or banking corporation, is entitled to the benefits of the Bankruptcy Act as a voluntary bankrupt.

(b) Any natural person, except a wage-earner or a person engaged chiefly in farming or the tillage of the soil, any unincorporated company, and any moneyed, business, or commercial corporation, except a municipal, railroad, insurance or banking corporation, owing debts to the amount of one thousand dollars or over, may be adjudged an involuntary bankrupt in default of an impartial trial and shall be subject to the provisions and entitled to the benefits of the bankruptcy law. The bank-

ruptcy of a corporation does not release its officers, directors or stockholders, as such, from liability under any of the State laws.

All other corporations, including those engaged in banking and transportation, are incapable of becoming bankrupts. The strongest reason for unsecured creditors to force a concern into bankruptcy is to prevent secret transfers of assets and to expose any past irregularities.

Bankruptcy is especially valuable at times as a means of invalidating liens or judgments that have been secured by favored creditors within four months of the period of bankruptcy.

Receiverships.—The objects sought to be obtained by the appointment of a receiver for an insolvent concern are an equitable settlement with creditors, readjustment of its finances, to preserve the concern's organization and to continue its business.

A receiver is an officer of the court, and the appointment of a receiver for any concern brings it under the protection and supervision of the court.

Upon application, the court sometimes appoints receivers for corporations on account of causes other than insolvency. Such causes may be summarized as follows: In the event of an action being established showing a violation or violations of the law; in an action to dissolve or annul a corporation; in proceedings for the voluntary dissolution of a corporation.

Unlike petitions in bankruptcy, a petition for the appointment of a receiver may be presented either in the federal court or in any of the State courts having jurisdiction. It is often the cause of conflict and confusion between the courts.

Proceedings for the application of a receiver vary somewhat in the different States. Except as stated above an application can be made in all States to the federal court. The procedure outlined herein is that of an application for a receiver of a New York corporation to a court of the State of New York.

How Appointed.—Every application made for the appointment of a receiver, other than applications made by the Attorney-general on behalf of the people of the State, must be made at a special term of the Supreme Court (the Court of Original Jurisdiction) held in and for the judicial district in which the principal business office of the corporation is located.

Duties of a Receiver.—Permanent receivers are the trustees of the property for the benefit of the creditors of a corporation and its stockholders. They are vested with all the property, real and personal, from the time of their having filed security as required by law, which they must give in such penalty as the court may direct. They must also take and subscribe to an oath that they will well and truly perform their duties. A receiver has the power to sue in his own name or otherwise, and recover all the property, debts and things belonging or due to the corporation. A receiver may, from time to time, sell at public auction all the property, real and personal, vested in him after giving public notice of such proposed action as required by law.

A receiver must keep a regular account of all moneys received to which every creditor and every person interested shall be at liberty at all reasonable times to have recourse. A receiver must call a general meeting of the creditors within four months from the time of his appointment. At such meeting, or adjourned meeting thereafter, all accounts and demands against the corporation must be presented, adjusted and filed; also the amount of moneys in the hands of the receiver declared. Out of the moneys in the receiver's hands they may first deduct all the necessary disbursements made by them in the discharge of their duty and for such commissions as may be allowed. All money or penalties recovered by the receiver shall be deemed a part of the property of the corporation.

Order of Payment by Receivers.—In the event that the receiver has sold any or all of the property of the cor-

poration, he must distribute the residue of the moneys in his hands as follows:

(a) All debts due by the corporation to the United States and all debts entitled to a preference under the laws of the United States. (b) All debts that may be owing by the corporation as guardian, executor, administrator or trustee. (c) Judgments actually obtained against the corporation to the extent of the value of the real estate on which there shall respectively be liens. (d) All other creditors in proportion to their respective claims without giving any preference.

If, after a final dividend is made, that is to say all claims paid in full, there is any surplus in the hands of the receiver, it must be distributed among the stockholders of the corporation in proportion to the respective amounts paid in by them severally on their shares of stock, provided, of course, that the corporation is to be dissolved. Any vacancy created by removal, death or otherwise may be supplied by the court. Any receiver who may be desirous of renouncing his trust, may apply to the court from whom his appointment was received for an order to all persons interested to show cause why such renunciation should not be accepted, and if accepted, the expense of the proceeding must be paid by the receiver. Receivers shall be subject to the control of the court and may be compelled to account at any time. Application may be made by the Attorney-general at any time for the removal of a receiver. All orders appointing receivers must designate therein one or more places of deposit wherein funds of the corporation not needed for immediate disbursement must be deposited.

Reorganizations.—In addition to reorganizing a corporation as the result of insolvency, it is often found desirable to do so in order to readjust its securities and the control.

The first step is the formation of a reorganization committee, the members of which should be parties in interest and well known as men of character, integrity and standing. The number of the members of such a committee is

usually three, five or seven, according to conditions. It is a well-recognized fact, however, that a small committee can formulate and complete a reorganization with greater promptness than a large one, owing particularly to difficulty in securing a quorum of a large committee.

To preserve harmony and to insure the ultimate success of a reorganization, a large committee is sometimes compulsory owing to the demands of the various parties interested, such as creditors, bondholders, and stockholders of the different classes demanding representation on such a committee.

Following the formation of the reorganization committee, its first duty is to make a thorough investigation of conditions and prepare the plan of reorganization.

The principles which generally control in formulating a plan of reorganization may be briefly stated as follows:

(a) Provision for working capital, also for immediate and future capital requirements.

(b) Readjustment of securities and modification of agreements so as to reduce the fixed charges to an amount less than the minimum earnings.

(c) Liquidation of floating debt.

In each instance the condition of a corporation or the circumstances surrounding it is different and the plan of reorganization must be prepared to meet the specific case. Generally speaking, however, the plan of a reorganization should be set forth in a deposit agreement between the members of the committee, a trust company to act as a depository, and such holders of securities, evidences of indebtedness of, and claims against, the corporation as may become parties to the agreement by depositing them under the terms of the agreement with the depository. In order that a large percentage, if not all, of the parties in interest will join in the reorganization, the agreement must be drawn so as not to arouse the hostility of any body of security holders or others interested. It must treat all with apparent justice and reconcile conflicting claims and interests. The agreement should provide, however, that the committee may organize a new corporation for the purpose of taking over, by foreclosure pro-

ceedings or otherwise as may be determined by the committee, all the property of the existing corporation; such a provision, in addition to serving its purpose, would discourage parties interested from refusing to deposit their securities or claims in the hope that the parties largest in interest would purchase them for cash at a price beyond their value rather than have the plan of reorganization of the corporation fail.

It is advisable that the agreement provide that securities and evidences of indebtedness or claims deposited should be accompanied by instruments of transfer in order to divest the holder or owner of all title thereto, such transfer to constitute an absolute and irrevocable assignment to the committee of the title to them, the right of the assignees being limited to acquiring such interest in the new securities as provided for in the agreement.

Cash Requirements.—As indicated above, a factor in a reorganization is that some means must be devised to raise cash to provide a working capital, also for immediate and future capital requirements. There are several possible methods of securing cash—one by the sale of some of the corporation's property, which is rarely ever feasible, as no doubt it would be covered by a mortgage or mortgages which would practically make it impossible, and if not would scarcely be advisable under the conditions that would no doubt exist. Another would be from the proceeds of the sale of new securities of the corporation, which would be practically out of the question, as obviously a corporation is not likely to fail unless it has exhausted this channel.

The only other is the assessment method, which is almost universal. If the latter is adopted the agreement should provide that the owners of a certain class or classes of securities and claims, as may be equitable and agreed upon, or owners of all classes of securities and claims who become parties to the agreement by the deposit of such securities and claims, should only be entitled to the benefits of the agreement upon the payment of a percentage at such rate as may be decided upon by the face

value of their securities and claims, for which assessment it is usually advisable that they be given a senior security. In a number of instances it is considered just that the entire assessment be paid by the stockholders, in exchange for which they do not receive any new securities whatever. Such payment, however, would in all likelihood increase the value of their stocks to at least a corresponding amount. Usually the cash needed by the corporation is not all required at once, and the terms of payment of assessments are spread over a period of time.

In some instances the working capital and immediate capital requirements are met by the assessment, and the future capital requirements are provided for through an open mortgage under which bonds can be issued and sold when additional cash capital is required.

Fixed Charges.—If the reorganization is to prove successful the total fixed charges, which usually consist of guarantees, rentals and interest, must be less than the net earnings of the corporation. In case the old corporation is dissolved by reason of the reorganization (which is the fact in most instances) it is, of course, released from all contracts and the new corporation may or may not renew them.

If guarantees of interest and dividends on subsidiary company securities are unprofitable, the opportunity is now presented to dispense with them. The holders of such guaranteed stocks or bonds will often submit to a reduction of the guarantee under such circumstances.

The above is also true with respect to rentals. The owners of a leased property would ordinarily have difficulty in leasing it to another corporation—this is especially true when the leased property has been built for the failed corporation, and the owners have, therefore, practically no choice in the matter but to submit to a reduction.

The most important factor, however, is the scaling of interest-bearing securities by the substitution of dividend-paying securities of the new corporation for interest-bearing securities of the old. Sometimes interest-bearing

securities of the new corporation are exchanged for the old on a scaled basis, and in some instances the new securities bear a lower rate of interest than the old securities.

It is considered equitable in cases where bondholders have accepted a reduction of their interest-bearing principal to give them at least enough dividend-payment principal to bring the par value of the holdings in the reorganized company up to the par value of their old securities, thereby giving the holders a chance to share in the future prosperity of the company.

The liquidation of the floating debt is a matter that need not be discussed at length, as settlement would naturally be made with creditors for cash or securities, on the most advantageous terms. In some instances, however, their claims have been wiped out under foreclosure proceedings.

Voting Trusts.—Following the reorganization of a corporation there is a tendency on the part of security holders, particularly the smaller ones, to dispose of their holdings at a low price, and the aggregate of the securities thus sold might be considerable. In this manner they might fall into the hands of competitors or others antagonistic to the interests of the new corporation. In order to safeguard such a condition and to insure stability of management, financial and otherwise, it is advisable to place all of the new stock in the hands of voting trustees under a voting trust agreement for a period of years, or until such time as the new company is operating on a sound basis.

The stock is usually held by the voting trustees jointly under a voting trust agreement which prescribes their powers and duties, and until the delivery of the capital stock is made, these trustees issue voting trust certificates or certificates of beneficial interest in such stock.

XXIX

INJUNCTIONS

Classification—Perpetual and Interlocutory Injunctions—Cause for Injunction—Common and Special Injunctions—Cross Injunctions—Restraining Order—Jurisdiction of Equity Courts—Essential Features—Grounds for an Injunction—Criminal Actions—Reasons for Refusal of an Injunction—Judgments—Execution—State and Federal Courts—Violation of an Injunction—Injunction Bonds—Modification—Dissolution—Continuance—Damages—Costs, etc.

XXIX

INJUNCTIONS

AN injunction is a judicial command, issued upon the request of one party, by a court of equity, restraining another either from doing, or leaving undone, as the case may be, some particular action.

Classification.—Injunctions are divided into two general classes: preventive and mandatory. The effect of a preventive injunction is to *restrain* the commission of any act, or the continuance of the same, when such would result in injury to the one by whom application for the injunction was made. On the other hand, a mandatory injunction *requires* the performance of a certain action, when the omission of the same would injure the applicant. The preventive form of injunction is the one most frequently employed, the mandatory form being issued only in extreme cases, where otherwise serious damage would ensue if it was withheld, and the court, in the action taken, is governed wholly by the individual circumstances of the case.

The fact is clearly established that the power of a court of equity to compel the performance of an action in the affirmative is commensurate with its powers of prevention, but nevertheless earlier decisions were remarkable for the reluctance they exhibited in exercising their authority in that direction. However, the same results were attained indirectly by modifying the form of the command. For example, an injunction was issued in one case which had for its object the restoration to its place of a stop-gate which had been removed. The injunction granted did not command that the stop-gate should be returned to its place, but was “to restrain preventing the use of

the water by the applicant by removing the stop-gate," which was merely another way of ordering it restored.

Perpetual and Interlocutory Injunctions.—Another classification is made of injunctions in general, according to the time in which they are destined to operate, viz., perpetual and interlocutory injunctions. The function of a perpetual injunction, as the name would imply, is perpetually to restrain the defendant from performing a certain act or asserting some claim which in its character is opposed to the rules of equity. A clear right must be shown before a perpetual injunction is issued, and the burden of proving this right falls upon the one in whose interest it is issued. When a perpetual injunction is merely preventive in its character it loses its distinctive feature, should the cause for which it was issued be removed, or should a change in title to the property concerned result in depriving the complainant of his interest in the same.

An interlocutory injunction is temporary in its operation. Usually it is granted in order to prevent any change being made in the condition of affairs regarding the case in question until the same can be decided upon its merits. In consequence, an interlocutory injunction makes no pretense as to deciding the right or wrong of a case, but has for its sole object the preservation of the property in the existent condition at the time the injunction is issued, and the prevention of any action which might injure or endanger the right in controversy.

Such an injunction is never granted unless the urgent necessity for preventing damage of an irreparable character is present, and is usually refused if the relief so obtained would be sufficient for the satisfaction of the plaintiff without the case being heard in court.

Cause of Injunction.—An injunction is issued for specific cause and at the discretion of the court. The authority for its issuance is vested in the judge, and is governed by judicial reasons. An injunction of any sort should be granted only in cases of urgent necessity, and

unless the same exists great caution should be exercised in the use of such power.

Even if no damage might befall the person against whom the injunction might be issued, it should not be issued if unnecessary.

Common and Special Injunctions.—Interlocutory injunctions are subdivided into two classes: common and special. Common injunctions, however, are very little used. Their object is to prevent the continuation of legal proceedings until the defendant in the case has made his appearance and answer to the charges.

Special injunctions are based on the necessity of affording protection to disputed property until the dispute comes up for adjudication, and are granted in response to special application.

Cross Injunctions.—The term cross injunction is applied to the case wherein one person secures an injunction restraining another from interfering with certain property; and the person so enjoined having an equal right secures an injunction to the same effect against the first.

It has also occurred that when in reality the plaintiff in an injunction case was at fault the court has granted an injunction in favor of the defendant.

Restraining Order.—Frequently, where the advisability of granting an injunction is being considered, a restraining order is issued to the defendant for the purpose of preserving all the features of the case as they are until the next step is decided upon. The restraining order is operative until the hearing of the application for the injunction, and if the injunction is denied the restraining order automatically expires.

Jurisdiction of Equity Courts.—The power to grant injunctions has been one of the prerogatives of courts of equity since their inception. In England, in the early times, a complainant unable to secure redress for his wrongs through the medium of the common law resorted

to the king. The king's officer, the chancellor, was entrusted with the duty of hearing and adjusting all such complaints, and later courts of chancery, as they were termed, were instituted for this purpose. In the granting of injunctions the courts of chancery filled a long-felt want in the common law, for whereas the law might endeavor to find means of reparation for actions of injustice after they were committed, it was powerless to move in the direction of preventing such actions.

In many cases, also, an action for damages which was the only legal remedy for fraud, was very inadequate in remedying the injury done. In England courts of chancery or equity and courts of law were separate and distinct; the office of courts of equity being to ameliorate the severity of the common law and supply its deficiencies, which it was able to do through the manner in which its jurisdiction was exercised. This jurisdiction was termed *coordinate*, if it was possible to obtain relief at either law or chancery; *supplementary*, when it enforced new rights for the purpose of protecting those recognized by law; and *exclusive* when rights were protected of which the law took no notice. In the United States, with few exceptions, there are no separate courts of equity, the same judge sitting upon the case according to its nature, as a court of law or a court of equity.

In 1848 the State of New York abolished the distinction between the two courts, and other States have since followed this example.

Essential Features.—Let us now consider the features which are essential in order that an injunction may be obtained. As a general rule it may be stated that inasmuch as the function of a court of equity is to supply the deficiencies of the law, an injunction will not be granted when a full and adequate remedy may be obtained for injury through the ordinary processes of law, neither will an injunction be issued where only a nominal value is involved, unless fraud of the grossest sort is present. On the other hand, if the remedy at law falls short of granting the relief to which a complainant is entitled,

jurisdiction is founded in equity. It is not sufficient that a more or less defective remedy at law may be obtained; it must, if obtained through a law court, be equally practical and efficient with the remedy in equity, and where a perfect remedy may be obtained in equity there is no necessity for speculation regarding relief through law. In many cases where the injury resulting from certain actions is such as is incapable of being estimated in dollars and cents, an injunction will be granted for the protection of the complainant. For example, a person exercises the privilege of a right of way over another's property for twenty years or more. In that time, a right to such right of way would be acquired by prescription, and if the owner of the property at any time should deny such right it could be enforced and the way kept open, only by injunction. In such a case damages would not be a suitable remedy, for if the right of way was the only means of communication with the main highway, no amount of damages could compensate the complainant for its loss. As another example of the application of an injunction a case might be mentioned where certain premeditated acts, if committed, would result in terminating development work on a mining claim. No estimate could be made of the loss incident to ceasing work on an undeveloped claim, and here again an injunction against the performance of such acts would be the only appropriate remedy.

In addition to the existence of certain facts and conditions in connection with a cause for complaint, a certain line of conduct on the part of the complainant is essential before an injunction will be issued. When the power of a court of equity is invoked for the protection of the rights of a complainant, the application for an injunction must be made in due season, or the privilege of obtaining relief through equitable proceedings may be lost.

Take for example the case of a person who, being fully cognizant of his rights, stands by and allows another to infringe upon said rights without offering any protest until his opponent has been subjected to considerable ex-

pense or made a party to binding agreements. The granting of an injunction at such a time forbidding the completion of the enterprise, or its utilization when completed, would be a very serious matter to the person in error, and it is extremely doubtful, if a court of equity could be induced to grant any injunction at such a time, although redress might be obtained through the ordinary processes of law.

Courts of equity are particularly reluctant in granting injunctions the object of which is to restrain the completion or use of works of a public character, or where the granting of the injunction would result in injury to the public at large as well as the individual against whom it was obtained. Delay in instituting proceedings, however, will not militate against the granting of an injunction, when the case is such as can not be tried by law; or where no injury accrues to the public or the person against whom the injunction is issued by virtue of such delay.

Grounds for an Injunction.—In order that relief may be obtained through the issuance of an injunction the plaintiff must establish the fact that he has been subjected to an actual injury of some consequence at the hands of the defendant. A minor or inconsequential injury may furnish grounds for nominal damages, but is not of sufficient gravity to warrant issuing an injunction. An injury for which, or for the prevention of which, an injunction may be granted, must in its character be irreparable. An injury may be irreparable for three reasons: its nature may be such that no adequate compensation can be made in the form of damages, or such that no estimate of its magnitude can be made by any pecuniary standard; or the person upon whom the damages would ordinarily be assessed may be insolvent. When the injunction is to be issued for protection against the consequences of some expected future act, the court must be convinced of the reasonable probability of such act being committed. The bare possibility of an act being committed is not sufficient cause for granting an injunction.

Criminal Actions.—As a general rule, a court of equity has no jurisdiction over criminal actions and can not interfere for the purpose of preventing the same, unless the rights of property are threatened or interfered with; but if such interference occurs and there is no adequate legal remedy at hand the rule is inoperative to restrain a court of equity from preventing such actions. In the granting of injunctions, precedent plays a part, but a part of much less importance than in the administration of the law. The courts are granted a wide latitude in the treatment of cases in equity, in order to dispense substantial justice in new and novel cases constantly occurring.

Reasons for Refusal of an Injunction.—Viewed from the courts' standpoint, one of the first features to be considered in issuing an injunction is what is termed the balance of convenience, or, differently expressed, whether a greater injury would or would not result by granting the injunction than by refusing it. Ordinarily an injunction will be refused when the injury consequent to its issuance would exceed the same in the event of refusal, except in cases where the actions complained of are so atrocious that the person against whom the injunction is issued forfeits all claims to any consideration whatever.

When the granting of an injunction tends to work an injury to the public, such fact is also given due consideration and furnishes yet stronger ground for its refusal. A court of equity has no power to take property from one and give it to another, any more than could be done by any other court, unless the defendant in the case be given a proper hearing. In consequence, a preliminary or interlocutory injunction can have no concern with the title to property. An exception to this rule, however, is found in a case where the possession of the defendant is but an interruption of the earlier possession of the plaintiff, and if the right of the plaintiff to the property in question is clear, an injunction may be issued for its return to his possession.

When an injunction has been dissolved by the court,

or the request for one has been refused, it constitutes an irregularity to enter a second application on the same grounds. It is also irregular to apply for a number of successive injunctions on slightly varying grounds which might have all been provided for in one proceeding.

Judgments.—Under certain conditions the protection of an injunction may be secured for staying an action in a court of law. No pressure is brought to bear upon the court itself, but rather upon the persons appearing before it, and to whom the injunction is addressed. An injunction, however, will not be granted on grounds which should more properly be offered as a defense to the action, but an action in a court of law may be enjoined when the defense is equitable in its character and inapplicable to a court of law. In cases also where, through accident, fraud or mistake, one party secures an unfair advantage over his opponent in an action at law which is beyond the power of the court to correct, a court of equity may interfere and administer relief on an impartial basis.

In England, at one time, the Courts of Chancery exercised a certain jurisdiction in matters of a criminal nature, but with the extension of the powers of the common law courts, this jurisdiction terminated, and at present, both in this country and England, the rule is well established that equity courts have no jurisdiction in criminal proceedings. It is only for the most forcible reasons that a court of equity can be induced to grant relief from the judgments of a law court, particularly if the grounds upon which the request for an injunction is based might have been advanced as a defense in the legal proceedings. However, if the neglect to take the proper steps in the law court was due to fraud or other circumstances beyond control, equity will grant relief. The grounds on which a judgment at law may be set aside by an injunction are too numerous to be gone into in detail, but they may be summed up and the statement made that, when a judgment is obtained through fraud, accident, mistake or improper circumstances of any sort, the same may be set

aside, provided the plaintiff has used proper diligence in his own defense.

Execution.—As a general rule equity will not interfere with the right of a creditor to levy upon the property of a debtor against whom he has obtained a judgment. It has also been decided that when property subject to levy can be sold only at a price much beneath its actual value, by means of the small demand for such property, that equity will not restrain the sale.

Courts of law are usually in a position to exercise a supervisory power over the result of their own actions, in order to prevent abuse or unfair advantage being taken of the same, but executions have been enjoined when the matters involved were of the character of those subject to a court of equity.

State and Federal Courts.—The relative authority of the State and federal courts is clearly defined by statute in the matter of granting injunctions. According to a statute of the federal government, a United States court can not enjoin proceedings in a State court except in cases where an injunction would be authorized by a bankruptcy law. With this exception, a federal court is prohibited from interfering in any State court proceedings, provided that the action has had its beginning in a State court. However, if the action had its beginning in a federal court, the statute has no application. In this way, either court has full control over the way their judgments and decrees are enforced, as well as the form in which they are rendered.

The powers of the different State courts were also formerly restricted in a similar manner, with regard to each other, but at present the rule is well established that for proper cause the court of one State might enjoin proceedings in that of another State. The essentials in order to obtain such relief are that the plaintiff should show a clear claim in equity and that the defendant should be within reach of, and subject to the court's authority. A court of equity has no jurisdiction over the

actions of a legislative body, and even if legislation in process of enactment be unconstitutional, no redress is obtainable until after the act has been passed, when it may be declared unconstitutional and void by the judiciary.

Violation of an Injunction.—The violation of an injunction is a contempt of the court by which the injunction was issued, and may be punishable by fine or imprisonment, or both. The defendant is bound at his peril to obey the court's command and, if in any doubt upon the character of the same, should seek advice. To be guilty of contempt of court from this cause, it is necessary that the defendant should be cognizant of the injunction, even though he may not have been formally served with notice of the same, but acquired his knowledge from any source whatever, provided it proceeded from a source entitled to credit, and stated explicitly what acts the defendant must refrain from doing.

Injunctions issued against a corporation are binding upon the corporation and the individuals entrusted with the conduct of its affairs. In former years the opinion was held that, since a corporation could not be attached, owing to its impersonal character, it could not be held liable for contempt of court. The modern doctrine, however, is that a corporation may be held guilty of contempt when it violates an order of the court, and that it may be fined and its property sequestered.

An injunction is not only binding on the individual against whom it is issued, but also upon his agents, for whose actions he is responsible. He is relieved from the responsibility, however, if the injunction is violated by his agents in opposition to his commands. Such also is the case if the act of violation is performed by strangers without his knowledge or consent; but he will be held liable if he aids or counsels such strangers in disobeying the injunction.

The laws are very strict in the matter of observing the commands of an injunction, and it has also been decided that no matter how unreasonable or unjust an injunction

is, it must be obeyed while it is in existence, unless it can be shown that it is absolutely void, as is the case if the injunction were granted by a court having no jurisdiction.

The motive governing the violation of an injunction is given no consideration as an excuse, although under some conditions a sentence may be mitigated on this account. Sickness, however, is a valid excuse for the non-observance of an injunction requiring some affirmative action.

When the order of a court is manifestly unjust and unreasonable, the injured party must seek redress through a reviewal of its provisions, not through disobedience; for in proceeding against any one accused of violating an injunction, the court will pay no attention whatever to the merits of the cause in the interests of which it was granted, but confine itself wholly to a consideration of the subsequent proceedings.

For some years after their inception, injunctions were frequently issued upon the request of a plaintiff, without any opportunity being given to the defendant to present his side of the case. It also frequently happened that on a final hearing the injunction was found to have been issued without proper cause and was dissolved.

Injunction Bonds.—In the meantime, however, the person against whom the injunction was issued may have been subjected to loss incident thereto for which he could obtain no redress, unless it could be proved that the issuing of the injunction had been prompted by malice. The abuse of such powers of the injunction was instrumental in inducing the courts to require from the plaintiff a bond guaranteeing the defendant immunity from loss in the event that, upon final consideration, it should be decided that there were no grounds for the injunction having been granted. In most of the States, statutes are now in force which make the filing of a bond a preliminary essential to the issuance of a temporary injunction. There is no necessity for a bond in connection with a permanent injunction which effectually determines the rights of the disputants.

The proceedings incident to the execution of an injunction bond are governed by the statutes of the State in which it is issued. The bond, when such is required, must always be executed before the injunction is granted, but the place of execution and the approval of the bond are matters regulated by statute. As a general rule, an injunction bond is made payable to the adverse party, and is for the benefit of all the defendants who are enjoined. The form and provisions of a bond are also frequently pre-determined by statute, and must, at least in its general terms, conform to the terms of the statute. In many cases a defective bond has been considered sufficient cause for the dissolution of an injunction.

In determining the amount of an injunction bond, the court takes into consideration the probable amount of damages that the defendant is likely to suffer in the event of the injunction being issued and eventually dissolved upon final hearing. In consequence, it is usually the aim to establish such an amount as will indemnify the defendant to the action to the full extent of his loss.

Modification.—When an injunction, as issued, fails to render exact justice to the parties concerned, it is within the province of the court to modify or partially dissolve such an injunction, provided the real character of the instrument is not changed thereby.

Dissolution.—It is an established fact that a court having the power to issue an injunction has also the power to dissolve it. Such power is inherent in the court and its exercise, like that of creation, is largely at the discretion of the court. Ordinarily a dissolution of an injunction must be obtained through the same court by which it was provided, except in instances where the dissolving power may be vested in a different authority by statute.

In considering the dissolution of an injunction, features are involved similar to those taken into consideration when the application for the same was in question. The same effort is made to “balance the inconvenience,” and its continuance or dissolution may be decided upon by the

relative importance of the injury that will be done to the plaintiff by its dissolution, and that done to the defendant by its continuance. Under some conditions, an injunction will be dissolved without any question. For example, if an adequate remedy is obtainable at law, where the amount involved is insufficient, where the bill for the injunction is brought in the wrong county, or where the court has no authority to grant injunctions at all. Usually a mistake of the chancellor in issuing an injunction constitutes adequate reason for its dissolution, or if its commands are vague and uncertain so that it is practically impossible to know the intentions of the injunction, it may be dissolved. An unusual delay on the part of the plaintiff in the prosecution of his case has also been considered sufficient grounds for the dissolution of an injunction, unless the situation is such that it is in the power of the defendant to pursue the case. Irregularities in the issuance or serving an injunction are also grounds for its dissolution. Other causes for dissolution are: The failure of the plaintiff to comply with the condition governing the issue of the injunction, a defective injunction bond, and failure to notify the defendant of the application for the injunction when he is entitled to such notification.

The issuance of an injunction upon the strength of an unconstitutional statute, where there have been errors in the bill on which the injunction was issued, or where there has been suppression or misrepresentation of material facts on the part of the complainant when applying for its issuance, is sufficient ground also for dissolution.

Continuance.—An injunction is ordinarily continued, where such continuance would be productive of less injury than its dissolution; where a dissolution would be equivalent to a denial of the relief to which the complainant is entitled, as may be proved at the final hearing, or where some doubt exists as to the relative strength of the claims of the opposing parties.

Damages.—When matters arrive at the point where an injunction has been dissolved and the assessment and

award of damages are in order, the rights of the parties in this relation are determined usually by the courts of law. The statutes governing this phase of the question in different States are not wholly uniform, and in many cases the only way in which damages can be properly ascertained is through an action on the injunction bond. Damages can not be assessed on account of anything which is not the direct result of the injunction, and it is not permitted to recover for remote or speculative damages. Decisions differ in regard to whether damages may be awarded in excess of the amount stated in the bond, or not, and also in regard to the assessment and award of exemplary or punitive damages.

Costs, etc.—As a general rule the expenses attaching to the dissolution of an injunction may be recovered after dissolution is effected, and in certain cases counsel fees also have been allowed. Evidence is frequently required to prove that legal services have been rendered, and the court usually is guided in rewarding such services, not only by the time expended, but also by the magnitude of the interests involved.

THE BALANCE-SHEET

How it Differs from Statements—Arrangement of Balance-Sheet—Special Precautions—Classification of Assets—1. Actual Cash—2. Quickly Convertible Items—3. Assets Not Quickly Convertible—Debtors' Accounts—Bills Receivable—Freehold and Leasehold Investments—4. Doubtful Assets—5. Items Depending upon Continuance—6. Unrealizable Items—The Liabilities—Secured Creditors—Trade Creditors—Discounted Bills Receivable—Other Liabilities—Capital—Surplus Balances—Interpreting the Balance-Sheet—Recovery of Invested Capital—Conclusion.

XXX

THE BALANCE-SHEET

A BALANCE-SHEET may be defined as a concise statement prepared to ascertain the financial position of an undertaking at a given date. It is not necessarily a statement of assets and liabilities, although when dealing with the principles of elementary bookkeeping it is so regarded. A balance-sheet rarely shows the fixed assets at the market or salable value, while among the so-called "assets" and "liabilities" are included items of a suspense nature, which although appearing in the books as debit and credit balances can not be regarded as resources or liabilities.

How It Differs from Statements.—The term balance-sheet is often incorrectly used by the uninitiated as describing an income and expenditure account, a summary cash account, or, in fact, almost any summary statement of accounts which shows the same totals on debit and credit sides. It is not unusual to hear of a "Balance-sheet for the year ending December 31st," whereas it should be a "Balance-sheet on December 31st." It differs materially from a statement of affairs, which also is a summary of assets and liabilities at a particular date. A statement of affairs is drawn up with a view of presentation to creditors, generally in cases of insolvency. It is designed to give such a view of the debtor's affairs as will enable the creditors to know how to act, and it therefore brings together all possible assets at the values they may be expected to realize, and all possible liabilities at the figures for which it is expected claims might legally be made; the difference between the two sides resulting in a "surplus" or "deficiency," as the case may be.

A balance-sheet, however, looks at the company or individual, not as a debtor accounting to creditors, but as a going concern. It includes the assets and liabilities at the figures at which they properly stand in the books of a concern, and it might be described as simply bringing together the balances in the books in proper order, provided first of all it be assumed that the books are properly written up and adjusted. It by no means follows that assets must always, in the case of a going concern, be set down at figures which they would yield by realization. An example will show this. A company may be trading at a loss, and be on the eve of liquidation, but an item of "good-will" may quite properly appear among the assets, although it may be obvious that, if the good-will were put up for sale, it would realize nothing, and on a liquidation supervening, the good-will would find no place in the statement of affairs. There will less often be differences between the liabilities side of a balance-sheet and a statement of affairs, since liabilities are, with very few exceptions, definitely ascertainable amounts in prosperity as well as in insolvency. There may, however, be contingent liabilities whose real existence is not sufficiently determined to warrant or require their inclusion in a balance-sheet, which yet would properly and necessarily appear in a statement of affairs.

The clerical work involved in the conversion of the trial balance into the balance-sheet and profit and loss account has been referred to in *Bookkeeping* (p. 315); the purpose here is to deal with construction and criticism of the balance-sheet, *per se*.

Arrangement of Balance-Sheet.—The arrangement of the items herein is a matter worthy of more attention than it sometimes receives. It is desirable to see at a glance not only the total amount of the assets and liabilities and of what those totals consist, but also the strength or weakness of the company's financial position. It should show not only whether the company has actual property to meet its actual debts, but also whether it has available property to meet its immediate pressing debts. To attain

this object the obviously correct course is to arrange the assets in the order in which they will presumably be collected, and the liabilities in the order in which they will presumably require to be paid. Suppose, for example, a corporation shows a balance-sheet with undivided profits of 20% of the capital stock, and the assets are known to be conservatively figured. If the assets prove to be worth all they have been estimated to be, can the firm go into bankruptcy? As a matter of fact, many firms have gone into bankruptcy under just such conditions. They had large accumulations of profits and those profits were real. Yet bankruptcy followed because the liabilities happened to be immediate and the resources remote. In a case of this sort, a reorganization of the business will usually permit the ultimate payment of one hundred cents on the dollar. A balance-sheet which gives no hint of the fact that the liabilities are immediate and the resources remote is not, therefore, entirely satisfactory. It should be so arranged that the "current assets," as they are called, can be compared with the "current liabilities." It would be well to make the comparison upon the sheet, thus dividing the items into two classes—long term and short term; but, in any case, the items should be so clearly designated that any intelligent reader can make the comparison with a fair degree of accuracy.

The first item among the assets, therefore, should not be, as is sometimes seen, a large figure for "Mining Property" or something of that sort, but should always be "Cash," and the first item among the liabilities should not be "Capital," but should be "Bills Payable," "Accounts Payable," or something of the kind.

Special Precautions.—Great care is necessary to make sure that all balances are included under headings that correctly describe their nature. When after exhausting all the principal captions there is a residuum of items which can not accurately be placed thereunder, and are not important enough to have headings of their own, they may be appropriately described by coupling the word "sundry" with "debtors," "investments," or whatever it

may be. Debit balances which, though properly appearing among the assets, are yet not tangible property, but book entries—such, for example, as “prepaid rent” or “insurance premiums paid in advance”—should not be lumped together with tangible property, but separately stated and accurately described.

The treatment of property subject to a mortgage or other charge requires care. Where the company is not itself personally liable for the mortgage debt, but the liability only attaches to the property, the mortgage should not appear on the liability side, but should form a deduction from the value of the property on the asset side; for example, where a company buys an equity of redemption—that is to say, buys property which is already mortgaged, and buys it subject to the mortgage—without entering into any personal obligation to pay off the mortgage. If, however, the company has itself borrowed the money for which the mortgage is given and has given its bond or has otherwise become primarily liable for it, and the creditor could sue the company quite apart from exercising his rights against the security, then the debt should appear among the liabilities, but words should be added to show upon what tangible or realizable asset it is secured.

Special care is necessary in dealing with any transactions which are outside the scope of the company's powers. The balance-sheet should include the figures relating to any such improper transactions under such descriptions as would enable a person acquainted with the regulations and powers of the company to recognize their impropriety. This need not be stated in so many words, but if the unauthorized investment or other improper transaction is included with others under such a description as does not accurately convey the real facts, the balance-sheet can not be called full and fair. It is difficult to emphasize too much the necessity of carefully attending to the provisions of the charter and by-laws of a company; not only are any direct provisions they contain as to the method of stating the accounts to be followed, but they indirectly suggest what items must be separately disclosed by pre-

scribing the transactions into which the company and the directors may and may not enter.

Classification of Assets.—The following method of grouping the items on the assets side will be as practical a form of dealing with them as any:

1. Assets of actual cash, or which can be immediately converted into cash.
2. Assets which can be realized at comparatively short notice.
3. Assets which will take a certain time to realize.
4. Doubtful assets which are only expected to realize a certain percentage of their value.
5. Other items which can only be realized so long as the business is a going concern.
6. Unrealizable items.

1. Actual Cash.—With reference to the first item, or assets of actual cash, or which can immediately be converted into cash, this will, of course, include the cash on hand and the balance at the banks.

Sometimes the item reads "Cash and cash items." "Cash items" may mean anything under the sun. It may mean a slip of paper in the cash drawer, containing a memorandum that \$10,000 has been paid out on a bond, or that 50 cents has been paid for car fare; or it may mean that there has been deposited in the cash drawer a note on which the money may be collected some time. In a conspicuous case made public a number of years ago, these cash items included more than half a million dollars of worthless claims maintained simply to pad the assets. Any one invited to invest in a corporation should demand a full explanation of any such items. Some corporations avoid the possibility of misunderstanding by stating exactly where their cash is to be found, naming the amount on deposit with different banks and trust companies, etc., and stating the amount actually in the company's own vaults. This is proper reporting not only from the popular side but also from that of the accountant.

2. Quickly Convertible Items.—Under the second heading, or “assets which can be realized at comparatively short notice,” may be included all investments which can be converted into cash without undue delay.

For the purpose of ascertaining whether the investments as shown in a balance-sheet may properly come under the second and not under the third heading, a list of the investments will have to be obtained by the accountant, who, by comparing these details with the Stock Exchange quotations, will be able to make his own calculations as to the correctness of the value placed upon them, and whether they can be sold so as to place the amount realized at the disposal of those directing the commercial concern within an interval not exceeding, say, thirty days.

3. Assets Not Quickly Convertible.—The third group, consisting of assets or property which, while admittedly of value, would take a certain time to realize, will form probably the bulk of the assets of a commercial concern. Under this heading may be included investments which are not quoted on the Stock Exchange, or if quoted are of such a nature as to require gradual realization. In the official lists of the various exchanges there are a very large number of investments whose quoted prices can not be altogether relied upon when considering them for purposes of rapid realization.

These observations apply perhaps more especially to mining companies, where the sale of a certain number of shares will at once so affect the market price as to render it impossible for the immediate realization of a further quantity to take place without a considerable fall occurring in the quotation, hence care must be exercised in disposing of such inactive securities.

Debtors' Accounts.—In the same group will be included the amounts due by the debtors to the concern. It is almost impossible, where these amounts are brought together under a simple heading, such as that of “Accounts Receivable,” to gage their value as an ultimately

realizable asset, and it is still more difficult to know how much of it may be relied upon to be collected at short notice, should funds be required by the concern for any special purpose. For the sake of accuracy the debtors should be grouped, first of all, under the familiar sub-headings of "good," "doubtful," and "bad," and then, for the purpose of ascertaining how quickly the amounts can be available to meet emergencies, the "good" debtors should be further grouped according to the dates when they are likely to be converted into money. As regards the accounts which come under the heading of "doubtful," a certain amount, usually a percentage, ought to be written off and charged against the profit and loss account, the balance only being brought in to the balance-sheet; while any balances included under the heading of "bad debts" ought to be entirely eliminated, unless the balance-sheet has been prepared on the basis of bringing in the whole of the accounts among the assets, having on the liabilities side a reserve to meet any loss likely to arise on their realization.

Bills Receivable.—Bills receivable on hand would be placed among this group of assets, although, of course, should some mature in the course of a few days from the date of the balance-sheet, they might be included even in groups of one or two, according to the dates, but under a separate caption. Speaking generally, however, they will come under the same group as the amounts due from the debtors on open accounts, being of a similar class subject to the difference that the actual dates for their payment are definitely fixed.

Two differences between bills receivable and accounts receivable may be in some conditions important. A note is sometimes indorsed by a third party, who thereby guarantees payment if the first party fail. Such notes are better than accounts receivable to the extent of the added security. Again, a note is evidence that the debtor has recognized the debt and its amount, whereas a book account may be disputed. It would generally appear, therefore, that when one is judging the solvency of a

business, bills receivable are preferable to accounts receivable. There is, nevertheless, one advantage in an account receivable over a note, which under some conditions may be worth recognition. The man who has paid his debt by means of a note is relieved of his responsibility for the original debt, and stands liable merely for payment on the note. The goods for which he incurred the debt can not therefore be reclaimed by the seller, except as any property of his may be seized for debt. If, on the other hand, he has not given a note, his liability stands on the books in relation to specific property, and this, under some legal conditions, the seller may claim.

One of the most important items of this group in all manufacturing and trading concerns would be the stock in trade, consisting of manufactured goods and raw materials, and in order to value this item properly, it is necessary to be informed of the number of facts not likely to be stated on the face of the balance-sheet itself. It is, of course, impossible to lay down any fixed rules which apply to the criticism of the value placed upon stock in trade generally. In some commercial concerns the stock consists of perishable goods, and in that case a very large amount of depreciation ought to be allowed for stock that has been long on hand; while the same remark will apply, but from a totally different point of view, if the stock on hand does not deteriorate but becomes unsalable through obsolescence. This applies to all dressmaking and millinery businesses; also to concerns handling stocks of fancy stationery and holiday novelties; while even with furniture dealers and upholsterers changes in fashion cause their stock in trade to depreciate in value. Though theoretically a quickly realizable asset, this item of stock in trade should be considered strictly on its merits in each particular case.

Freehold and Leasehold Investments.—These are included in what may be described as the best class of assets, and they are the principal items which would come under the heading of “investments representing

fixed capital," or under the better classification, "fixed assets."

These items do not, in many instances, represent the whole of the fixed assets, and, in the case of commercial concerns owning plant and machinery, such property, together with furniture and fittings, implements and other working tools, would all come under the heading of "fixed assets," but would be placed in the group of assets now under consideration.

In the case of a concern owning a large amount of stock in trade which is never reduced in value below a certain minimum, the capital invested up to that minimum is sometimes treated as an investment of "fixed capital," or as a "fixed asset," and the excess as part of the "quick" assets. Of course, the amount expended in the acquisition of a business, or what is commonly known as "goodwill," is certainly another investment of "fixed capital." Neither of these items would, however, be included in this group.

The value affixed to the item of freeholds requires consideration. Matters of importance are as to whether the neighborhood in which the property is situated has improved or deteriorated; and if there are buildings attached, the age of any such buildings, and whether they have been maintained, since erected, out of revenue; also whether any expenditure of this description has been added to the original so as to swell the value of the asset in the balance-sheet.

In the case of leasehold property the same points should be noted as regards the neighborhood; while with reference to the buildings erected thereon, the profit and loss account should be charged with "depreciation," so as only to leave on the asset side a value proportionate to the unexpired term of the leases.

Furniture is also included in this group, but, as a rule, this is a matter of small concern except in the case of a hotel, where it is, of course, of paramount importance that full depreciation shall be charged for the heavy wear and tear, more especially in the case of some of the more perishable items, such as carpets, linen and tableware.

4. Doubtful Assets.—Doubtful assets are only expected to realize a certain percentage of their value. An example of what would come under this heading would be the plant and machinery of a manufacturing concern. There may, of course, be a certain amount of loose machinery so new that a price somewhat near that stated in the balance-sheet might reasonably be expected to be realized; but, as a rule, plant and machinery are specially manufactured to the order of the company for whom such goods are intended, and consequently will be of comparatively little value to any one else, even to those carrying on a similar business.

It must not, however, be supposed that a balance-sheet should be criticized from the point of view of what the assets are likely to realize should the concern be wound up; the method of criticism must depend entirely upon what use is going to be made of such criticism when completed. All that is suggested here is that, in the consideration of the nature of assets of the description such as are under review, it must be borne in mind that there is a great difference from the point of view of value to be attached to the assets of what is known as a "going concern" and to those of a bankrupt concern. In the former case, of course, the sale price, or the breaking-up price, must not be taken into consideration, for if looked at from that point of view the balance-sheet of scarcely any prosperous concern would be found to indicate solvency. Trade and other fittings, of course, come under a similar heading, and will require the same amount of consideration.

5. Items Depending Upon Continuance.—Other "assets," which can only be realized in the event that a concern continues in business, may or may not be assets depending upon surrounding circumstances. For example, the item of good-will is, in the case of a firm, usually paid for in cash by the new to the old proprietors; but in the case of a corporation, it is nearly always acquired in exchange for shares in the company, or a proportion of each. Occasionally, but not fre-

quently, the vendors receive bonds in the company; but usually the purchase-money is represented entirely by shares, or by a combination of shares and cash.

In nearly every case the price paid by a corporation for the good-will of a commercial concern is very much higher than is usually paid to the vendors when the business is sold to private persons. This is, of course, only natural, as in the case of a sale to private persons the purchasers generally intend to devote the whole of their time and energies to the business, and consequently expect not merely to receive a dividend or interest on the investment of their capital, but, in addition, proper remuneration for the time and ability they devote to the management of the concern.

It therefore usually follows that the amount named in the first balance-sheet of a corporation in respect of good-will is far in excess of what could possibly be obtained should it be sold. This item must be regarded as representing the purchase price paid for it, assuming the commercial concern to be continued as a going concern paying reasonable dividends, and that the balance-sheet has not overvalued the assets, and also that due provisions were made for contingencies. In this case the value placed upon the item of good-will is practically beyond criticism. The good-will exists, and, having regard to the law on this subject, no shareholder or auditor has any right to complain should the amount never be reduced, but stand as an unalterable item on the asset side. But should the company not be paying fair dividends, and the general appearance of the balance-sheet lead one to believe that the days of the company are numbered, then the value placed upon good-will must be taken into serious consideration.

As an example of another item which would come under this group, "work in progress" of engineering and manufacturing companies may be selected. If this asset is calculated on the proper basis for the cost of materials purchased and wages expended thereon, the amount can not properly be objected to. The ultimate realization of this asset depends, however, entirely as to whether the

commercial concern is kept going until the completion of the work. Should anything occur to stop the business, or should anything happen to hinder the progress of the work, such as a strike of workmen, this unforeseen or unexpected event would have to be taken into consideration. For purpose of realization, the asset may even be worth nothing at all, or only a small percentage of the value ascribed. As a further example, timber in a mine can very properly be taken credit for at its cost price, or at cost price subject to depreciation, so long as the mine is being developed; but should it shut down the value might entirely disappear.

6. Unrealizable Items.—The sixth group includes items which are absolutely not realizable, but which, so long as the concern continues in business, may be included on the asset side. For example, the amount expended in advertising a business, or some special article, the benefit of which is expected to continue, may very properly be treated in suspense and carried to the balance-sheet, after charging a proportionate part of the expenditure against the profit and loss account.

It is part of an auditor's duty to ascertain whether this apportionment between capital and revenue has been made on a proper basis. A similar remark would apply to some unusual outlay on repairs to buildings, the benefit of which is expected to continue over a term of years, and which it would be unfair to charge in full against the profits of the year in which such expenditure has been incurred.

The most unsatisfactory item which can appear among the assets, and which certainly comes under this group, is a balance brought forward from the profit and loss account. Such an item must necessarily represent a loss on the trading of the concern up to date, subject, of course, to the question as to whether it is entirely the result of trading, or caused by any distribution which may have been made to the partners or shareholders. An analysis showing how this balance has been arrived at since the establishment of the concern, will be of assist-

ance in arriving at a general conclusion based on the criticism of the whole balance-sheet.

The Liabilities.—In arranging the liabilities it is desirable that the outside creditors should be first considered. Creditors may be either fully secured, partly secured, or wholly unsecured, except in the sense that all creditors are legally secured to the extent of the value of the free or uncharged assets belonging to the concern. Creditors of corporations whose stock is part paid are, in addition, further secured to the extent of the uncalled capital; while those of partnerships have the additional security of the private property of all who may be partners in the concern. The owners of many concerns are only able to carry on their business by supplementing their capital with borrowed capital. In the case of a corporation, the persons who supply this borrowed capital may hold bonds, which may be secured by a mortgage on specific properties; or they may hold what is called a general floating charge on all the assets of the company; or, they may hold debentures which are certificates of indebtedness only. In the case of a firm or an individual, borrowed capital is generally supplied by means of a mortgage on the specific assets, or by an ordinary loan made at a fixed rate of interest, with the additional right to participate to a certain extent in the profits of the business.

Secured Creditors.—It is of the highest importance that the balance-sheet should show whether any of the creditors are secured, and, if so, to what extent, also the exact conditions under which this borrowed capital is supplied. With this information it will be possible to ascertain what surplus of assets may be available for the benefit of unsecured creditors, after discharging all liabilities to fully and partly secured creditors.

As in nearly all cases where money is borrowed on security, the deed provides that the interest on the loan shall also be covered by the security, it is essential that the whole of the interest accrued on these loans should be included among the liabilities under the heading re-

lating to the secured creditors. Interest on all the other loans should be included among the liabilities under the proper caption.

Trade Creditors.—The next item for consideration is the amount due to the creditors for goods supplied to the concern in the ordinary course of business. These, known as "trade creditors," may be divided into two classes—namely, "bills payable" and "accounts payable."

Few balance-sheets are ever submitted which fully explain, without further inquiry, the financial conditions ostensibly set forth. It is possible for two concerns to show identical statements, although the business of the two may be carried on under totally different conditions. The amount due to the creditors on "bills payable" forms an example of what is meant. In one case the concern may have to pay within thirty days for goods purchased, while in the other case it may have credit varying from three to eighteen months. If the balance-sheet is being criticized for the purpose of carrying out a financial transaction which may alter the management of the concern, the consideration of the terms of credit as disclosed by an analysis of the "bills payable" account is of the utmost importance.

If there is an appreciable amount due to creditors on notes drawn for long periods, say, over six months, there must be taken into consideration the question as to whether this long system of credit will be affected by any change, or partial change, of ownership. The result obtained from the grouping of the creditors on "bills payable" will be useful, if it is desired to make calculations as to the period within which the funds on the assets side of the balance-sheet can be utilized in the discharge of these bills.

Bills Receivable Discounted.—One item closely connected with bills payable, but not usually shown, is of importance. Not only are notes sometimes indorsed for others, but commonly bills receivable are discounted, and when discounted must be indorsed. If any of the notes

discounted by the business prove worthless, they must be redeemed. Loss on worthless notes can not be shifted to some one else by the mere fact of discount. On all discounted paper outstanding, therefore, a concern has a contingent liability. Of course, this element of doubt applies only to bills receivable, discounted and not yet due. A method of estimating the element of doubt is obvious. Since all notes discounted have been recorded with the date at which they were to become due, the amount not yet paid is easily figured. It is safe to assume, in the absence of definite information to the contrary, that all indorsed notes payable at a past date were paid by the makers when due and therefore that the liability of the indorsers has ceased; for the law of indorsement requires the holder of a note to notify the indorser at once in case the maker fails to pay, else the holder loses all claim against the indorser. This notice is commonly called "protesting a note," and can be given only through a public official, such as a notary public. This sort of contingent liability need be figured, then, only on indorsed notes not yet matured and on protested indorsed notes, if any. The amount of allowance to make for such notes would naturally be the same percentage used in considering the value of bills receivable in the asset side of the balance-sheet—unless, as may have happened, the firm in choosing what notes to discount has selected those better than the average. This contingent liability for indorsed notes usually does not appear on the balance-sheet, for it does not appear as a liability on the books. It should appear, however, in a supplementary statement or appended note. In such statements the amount of contingent liabilities for indorsed notes should be mentioned, and it probably would be a satisfaction to stockholders to know what percentage of indorsed notes have had to be redeemed during the year just passed.

Other Liabilities.—Somewhat akin to this contingent liability is another on account of contracts and merchandise for future delivery. A contract signed in December for raw material to be delivered and paid for in Febru-

ary constitutes one of the liabilities of the business on January first. It can not, of course, appear upon the books, and hence can not appear in the main body of the balance-sheet. It should appear in a supplementary statement or appended note, so as to enable the stockholder to judge of the future needs of the business.

As regards the amount due to creditors on "accounts payable," no special remarks are necessary, unless it is desired to ascertain within what period the free assets can be realized for the purpose of paying these creditors, and this information can only be ascertained by inquiry.

There may, of course, be creditors of a special class, such as those who may have deposited money with the concern—but whether they are stated separately, as they ought to be, or included among other creditors, is not of so much consequence as regards the mere accuracy of the accounts. In addition to the foregoing, the balance-sheet of a concern may have among its liabilities, either shown separately or included among the "bills payable," loans from banks. The loans may have been effected merely because the bank rate is low, and it is preferable to take advantage of this condition of the money market to borrow rather than to sell securities; or because owing to a depreciation in securities, where it is hoped the prices at which they were purchased may again prevail, it is inadvisable to part with them. It may be there has been a difficulty in collecting the book debts, or in realizing stock, and that recourse has been had temporarily to the banks; or it may have been a case of dire necessity. Whatever reason, however, there may have been for the loan, the banks frequently take security, which fact should be disclosed on the face of the balance-sheet.

Capital.—Having obtained all the available information as regards the creditors of the concern, the items in the balance-sheet representing the amount due to the owners thereof by the concern itself, or what is known as the "capital," may now be considered.

Perhaps no term in economics has given rise to more

controversy than the definition of the word "capital." It may be said to have the following meanings :

1. Wealth which yields revenue.
2. Wealth set aside for future production.
3. Wealth set aside for the satisfaction of future needs.

John Stuart Mill, in originating the recognized classical distinction between fixed and circulating capital, gives the following definition: "Capital which fulfils the whole of its office, in the production of which it is engaged by a single use, is called 'circulating capital.' Capital which exists in any durable shape, and the return to which is spread over a period of corresponding duration, is called 'fixed capital.'"

As a result of this definition, "fixed capital" is thus invested capital—such as public works, railways, canals, machinery, houses, improvements to land, and, in fact, everything productive which is at the same time durable, and to a certain extent of a permanent nature. "Circulating capital" is capital represented by raw materials, metals, minerals, and actual produce of land, and of what is set aside for the sustenance of labor.

The exact advantages and disadvantages attached to the holding of the various classes of capital, if there is more than one class of stock issued, should be ascertained. It sometimes happens that the dividend on cumulative preferred shares is several years in arrears. Until profits are earned and a dividend declared, the preferred stockholders are not creditors for the accrued dividend due, and consequently the amount eventually payable to them must not be shown as a liability on the balance-sheet. Nevertheless, it is desirable that a memorandum be appended stating that such dividends are in arrear since the date of the last payment, otherwise a person who contemplated the purchase of the common shares might easily overlook the fact that before a dividend could be declared on the common shares a large amount would have to be appropriated for the preferred stockholders. Such a condition of affairs naturally holds the price of common stock to a much lower level.

Surplus Balances.—Should there be any items remaining among the liabilities on the balance-sheet of the concern, they must consist of ledger balances, representing surpluses of one or more kinds. That is, surpluses subject to the realization of the items on the asset side of the balance-sheet at not less than the value affixed to them.

The analysis of these balances may afford very important information, as one or more of them may clearly show what have been the actual net profits of the concern for the period terminated by the date of the balance-sheet. A balance-sheet does not by itself necessarily give any indication of the financial result of the business transactions for any particular period, which is the reason why so many banking firms, where the capital is held entirely by a few partners, have long been in the habit of issuing for the benefit of their customers a balance-sheet showing their financial position. But they do not publish with it the corresponding profit and loss account, the contents of which they consider to be a matter solely affecting the partners themselves.

Profits not yet carried to the capital accounts of partners, to all intents and purposes may be looked upon as part of the capital itself. In many cases it is the practise for the partners to carry these profits to the credit of their respective capital accounts in the private ledger before the balance-sheet of the firm is made out. In others, partners prefer never to alter their original capital, and leave these surpluses, or undrawn profits, standing to their credit in the balance-sheet under special headings. In other words, they like to treat their original capital as "fixed capital," looking upon the other as "working capital," so long as it remains in business, such "working capital" being available at any time for their own private use. This item so treated, however, leaves the balance-sheet unstable.

In the case of an undisposed balance of the profit and loss, or revenue account of a corporation, this is never added to the original capital, and therefore, as long as it remains in the business, forms part of the "working

capital" as distinct from the "fixed capital," unless it has been invested in fixed assets.

Interpreting the Balance-Sheet.—And now having classified the items on both sides of the balance-sheet, ingenuity must be exercised to make use of the material gathered together. Should the object of one's labors be merely the writing of an article for a financial paper, one will chiefly rely on the contents of the balance-sheet, with the assistance of the profit and loss account, which invariably accompanies it when printed. One will, also, in the case of old-established companies, probably have the advantage of being able to refer to both for the years immediately preceding, and thus find many ways of detecting weak points in the balance-sheet engaged upon. It will be possible to ascertain whether the company has been making proper use of its capital on the one hand, or overtrading on the other; whether the stock in trade has unduly increased in proportion to the increase in the sales; or, whether the amounts due by debtors are higher in proportion to the amount due to creditors than they were at an earlier period, say, five or six years ago.

If the object in view is to advise as to whether it is desirable to invest in the shares of an existing company, special attention should be paid to the following points: Whether the net profits for the few years just preceding have been steadily increasing, or the reverse, or whether they have been irregular; also the same as regards the dividends actually paid to the common shareholders; the percentage the gross profits for the same years bear to the sales, and also the percentage the net profits bear to such sales; the term for which money has been lent by bondholders or by other secured creditors, and if it matures within a fairly near period. It is of great importance that satisfactory arrangements be made for the renewal of such loans.

Recovery of Invested Capital.—The safety of the capital is, of course, of great importance. In all com-

mercial concerns, capital, when once invested, can be recovered in one of two ways:

1. By what is technically known as "winding-up" a concern—namely, a realization of the assets and liquidation of the liabilities, the balance representing, either for better or for worse, the capital originally invested in the concern.

2. By transfer, in which case the owner of the capital has to find a substitute, obtained in the case of a single owner by an absolute sale of the business as a going concern; in the case of a partnership, by finding one or more partners to take the place of the retiring partner; and in the case of a corporation by the sale of its shares.

In the first case, by a division of the assets into the groups suggested, an approximate idea may be formed as to whether they are not only sufficient to provide for the payment of the outside liabilities, but also whether there will remain, after so doing, enough to make good the capital of the owners. In the second case there will have to be considered: The nature of the business, the persons to whom the chance of acquiring such a business or a share therein might appeal, or the market price of the capital stock compared with that of other companies carrying on a similar business.

Conclusion.—The accounts of a concern are intended to disclose its position as respects its debtors, its creditors, and its owners.

Its relations to its debtors arise through the charges made to them for the sales of its products, or from debts of various kinds. Its liability to its creditors is created through the purchase from them of money, services, and materials required in the conduct of its business operations. No abstruse accounting theories are involved in either of these two relations, as their ascertainment is dependent only on the correct use of the proper means.

Not many years ago it was considered that if the results of the operations of a business and its financial position could be shown once a year, or at most at the end of semiannual periods, a more frequent statement

was not necessary. When business units were much smaller than at present, competition less keen, and the number of those interested in each enterprise fewer, such a practise was fairly satisfactory, although there were apt to be surprises in store when the results of the fiscal period were disclosed.

In the present era of huge enterprises, however, a year or even six months is too long to conduct a business without knowing definitely the result; therefore each month the management requires that statements be issued showing how the business stands, and what it has earned or lost. Hence have been introduced the monthly balance-sheet and profit and loss account, comparisons of which with the figures of preceding months will disclose the progress of the enterprise.

XXXI

AUDITING

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2. OBJECT AND ADVANTAGES

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1. Checking and Footing—2. Inspection and Analysis—3. Verification and Testing—(a) Purchase Records—(b) Sales Records—(c) Cash Receipts—(d) Cash Payments—Vouching—Verification of Income—Proving the Balance-Sheet—Verification of Assets—Verification of Liabilities.

4. SCOPE OF AUDITING

Wholesale Merchants—Manufacturing Traders—Retailers—Contractors—Breweries—Hotels—Club Accounts—Theater Accounts—Publishers—Mining—Banks—Executors' and Trustees' Accounts—Accounts of Institutions—Building and Loan Associations—Public Service Corporations—Conclusion.

XXXI

AUDITING

I. DEFINITION AND CLASSIFICATION

AUDITING may be said to be the critical inspection of the affairs of individuals, partnerships, associations, and corporations for the purposes of determining the accuracy and completeness of the books of account and subsidiary records, and ascertaining the financial condition of the undertaking examined. It is one of the oldest and one of the principal divisions of the profession of accountancy.

The ancient Athenians are responsible for the introduction of "auditors," though the word itself was not used by them. Their accounts were vouched orally by checking clerks; they were in fact, "auditors," for it was not until they had "heard" the accounts that the latter were engrossed on parchment and permanently recorded. It is, however, to the Romans that is owed the spread of financial organization over the greater part of the then known world. The College of Quæstors—a body of certain magistrates of ancient Rome whose chief office was the management of the public treasury—was to all intents and purposes an auditing body, inasmuch as part of its duty was to pass on the accounts of Roman bankers and to report irregularities to the tribunes. A quæstor was, therefore, a critic and his office was tantamount to that of the auditor of to-day, the importance of whose function, while largely recognized in the different parts of the British Empire, is only beginning to be understood in the United States.

The Professional Auditor.—There is probably no other profession, not even excepting that of law, which re-

quires of its members, if they would succeed, a higher standard of education, experience, and general business knowledge. The function of the auditor is to inspect and examine accounts which are already completed. He must be familiar with the general principles of commercial and common law, bankruptcy, and trusts; he must be acquainted with economic and banking principles, and with those underlying the valuations of property of all kinds. But his knowledge of all these subjects is a means to an end, and that end is the application thereof to that one subject of Accounts in which his skill specially lies. The professional auditor, both on account of his special training and on account of the fact that his energies are not distracted by other and dissimilar occupations, is of course the ideal auditor. Constant agitation regarding the inefficiency of amateur auditors has done much to draw the attention of the public to the danger of employing them, and it is to aid business men in selecting properly qualified advisers that a number of States have created the degree of "Certified Public Accountant."

Official Auditors.—As distinguished from the professional auditors there are the official auditors, who are employed to examine the accounts of National, State, and Municipal authorities. Official auditors usually work under disadvantages in that they are not only limited as to the scope of their inspection, but furthermore the time at their disposal is too short to admit of a thorough audit in most cases. Official auditors, as a rule, are not so proficient as professional auditors because nearly all of the appointments are in payment of political debts, with the consequent result that inexperienced and incompetent men are frequently chosen; and the salaries attached to the positions are for the most part too low to attract first-class men.

Staff Auditors.—Most of the large corporations, while employing staff auditors on a regular salary basis for much of the routine work, at the same time submit their

accounts for certification to firms of qualified professional accountants. Staff auditors often get into ruts and routine methods, and a defaulting cashier or manager who is at all ingenious may evade their check. Again, there is always risk of collusion between two men of the same staff whatever their respective positions. By the employment of professional accountants the difficulty of evading unfamiliar auditing methods is greatly increased and the risk of collusion is practically eliminated.

Auditing Classified.—The work of auditing is usually divided into three general classes, according to the information desired, as follows:

1. Continuous and completed audits, to determine the accuracy of the records.
2. Investigations, to uncover suspected fraud.
3. Examinations, to ascertain the earning capacity of a business on behalf of an intending purchaser.

1. Continuous and completed audits are similar in regard to details of inspection, but differ in the time of execution. The continuous audit is taken up at short intervals, usually once a month, and aims to cover the whole business during the course of the statistical period; the completed audit is not begun until the fiscal year has ended.

There are numerous advantages arising from the system of continuous auditing: The auditors are allowed access to the books at any and all times of the year at their discretion, and the anticipation of these periodical visits inspires the clerks to keep the books up to date; unintentional errors are quickly detected and rectified; the auditors are enabled to become thoroughly familiar with the particular concern under review and so suggest safeguards against fraud peculiarly applicable to that business; they learn the terms of credit granted and can compare customers' statements and note irregularities; they can criticize debtors' accounts and bad debts and report on them before the subject-matter is out of date; they can confirm book debts by private circular and by comparison of different sets of books to which they may

have access; they can detect and stop defalcations during the early stages. A more detailed audit is thus practicable, and no delay is experienced in issuing the profit and loss statement and balance-sheet, duly certified, at the close of the period.

The advantage claimed for the completed audit is that the books are more constantly in the possession of the auditors than in the case of the continuous audit, hence the risk of alterations in the audited work is minimized; a complete detailed audit is, however, only practicable in the case of a small concern. The ideal audit is a combination of both, by the employment of two independent accountants, one performing a continuous and the other a completed audit.

2. *Fraud investigations* may arise from a variety of causes, among them: A suspected embezzlement by a clerk; an indication of theft of goods or concealment of sales; or, the manipulation of accounts by an unscrupulous partner who aims to gain an advantage over his associates. The course of the investigation is determined largely by the circumstances surrounding the particular case. Due perhaps to the neglect of details which always accompanies prosperity, frauds and defalcations have become so numerous as to warrant the periodical inspection of every kind of a concern, and the keen business man of to-day considers the audit fee an excellent form of insurance premium.

3. *Examinations* on behalf of prospective purchasers are made principally to ascertain the earning power of a business. If a concern is to be sold at a price based on its earnings the profits must be accurately determined. Many corporations have been formed where the constituent companies have been purchased at, say, eight times the average yearly earnings. In such cases an error in arriving at or stating profits would involve a considerable difference in the amount of cash or securities transferred.

In such instances as the above, therefore, the auditor is chiefly interested in exact figures of the following items:

1. The amount of sales, by periodical comparison, and their authenticity.
2. The cost of goods sold, and the percentage of gross gain on the turnover.
3. The expenses and the percentage they bear to the turnover, and
4. The amount of working capital necessary to conduct the business.

The period for which these items are examined is of sufficient length to afford ample opportunity for the comparison of a number of years, usually upward of three years.

In reporting upon the earnings the accountant is always careful to state the net profit of the last year under investigation as well as the average for the period. In some cases the average might be satisfactory, but if the last year is less than the average the purchaser is put on notice that the business may be declining in value.

2. OBJECT AND ADVANTAGES

Auditing is undertaken usually for one or more of three purposes:

1. Detection of fraud,
2. Detection of technical errors,
3. Detection of errors of principle.

1. Detection of Fraud.—On account of its importance the detection of fraud is clearly entitled to be considered an "object" in itself, although it will be obvious that it can only be concealed by the commission of a technical error or of an error of principle. Fraud is a dishonest course of conduct resulting in wrong or injury to another, and the particular division of it with which auditing deals is the offense of altering, mutilating, or falsifying books or records with intent to deceive or defraud. Most frauds are intimately connected with the receipt and disbursement of cash. A cashier has, perhaps, greater facilities for dishonest practise than any other employee, especially in a small concern where he also posts to the

Ledgers. He may fail to account for cash received or he may enter as a payment cash which he has applied to his own use. The method of making all payments by check is becoming more universal and although this in itself is not a preventive, yet it places an additional obstacle in the way of the fraudulently inclined.

The omission of some one in authority to examine the Bills Receivable occasionally and compare same with the General Ledger Account once resulted in fraud remaining undiscovered for several years: A cashier having received checks in payment of accounts, entered them on the books as Bills Receivable, and misappropriated the amounts. This was done on many occasions and he took the precaution to find cash on the due date. At last the reckoning day arrived, and, having reached the limit of his resources, he decamped, leaving a serious deficit represented by a large balance on the Bills Receivable Account, for which, needless to state, there were no notes in existence. Fraud frequently occurs in connection with the payment of wages, and also in connection with the return of goods; to reduce the possibility of these to a minimum it is essential in the case of the former that as many clerks as possible be employed in the preparation of the pay-roll and payment of wages, and in the case of the latter each item should bear the approval of an authorized official not directly concerned with the handling of cash or merchandise. In connection with the detection of fraud, it is of the greatest importance that every concern should have in operation a sound system of internal check (see p. 344) by which the duty of each clerk should be clearly defined, and his work properly supervised, as the practical value of an audit very often depends largely upon the merits of the system in operation.

2. Detection of Technical Errors.—Technical errors, that is, departures from mechanical accuracy, are mistakes in the details of bookkeeping such as posting to wrong accounts, unintentional errors in transferring balances, arithmetical miscalculations, etc. In undertakings where the transactions are too numerous to justify

checking every entry it is usually possible to test the accuracy of the bulk of the work by aggregates which appear in subsidiary books and ledgers, and which are represented in a ledger by controlling accounts.

3. Detection of Errors of Principle.—Errors of principle include mistakes of omission and commission. One of the most serious is the omission to provide proper reserves for depreciation of assets subject to wear and tear or for shrinkage in values. A frequent mistake of commission, arising from ignorance of the fundamental law of accounts, is the inability to distinguish between assets and liabilities on the one hand and profit and loss items on the other.

Sometimes the error of principle arises from inability to see the true nature of the transaction. Some time ago a street railway made a statement to prospective buyers of the entire stock showing net earnings of eight per cent per annum for a period of nearly two years. The statement was made by the secretary, and was said to be a correct copy of the books. The intending purchasers sent an accountant to verify the statement, which was found to be absolutely correct, as far as the books were concerned. But there was an item of \$50,000 to the credit of profit and loss which arose in this way: The company was a combination of three other companies. In acquiring the constituent companies payment was made in stock, and some money. One man who received \$100,000 of the stock offered to sell it back to the company for \$50,000. As the company had just floated its bonds, the offer was accepted; Treasury Stock Account was charged \$100,000; Cash, of course, was credited \$50,000 for the money paid; and the question was, what to do with the other \$50,000. This question the secretary answered by crediting it to Profit and Loss, and, what was worse, he included it in the gross earnings in his statement. He was perfectly honest about it, and was very angry when the accountant threw it out and credited it to Plant and Franchise Account in the statement he made for his clients. A very simple analysis of

the relation between the Capital Stock and the Plant and Franchise Account showed that the Capital Account really represented no actual value since the road had been financed entirely with the bonds, and in order to offset the fictitious credit to Capital, the Plant and Franchise Account had been swelled to a corresponding amount beyond its real cost. In other words, the capital was all water and the transaction consisted simply in squeezing \$50,000 of water out of the plant, which should therefore have been reduced to that extent. Even granting that the good-will of the franchise was worth the whole of the Capital Stock Account, and that in consequence the item was to be considered a legitimate profit, it was in no sense an operating profit, but an accidental and sporadic one that should have been separately stated. In spite of the arguments of the accountant, the secretary stood his ground, and afterward furnished his own figures to the brokers who negotiated the sale of the bonds, and they were published by the brokers as a true statement of the earnings of the company.

This same street railway company's statement afforded an example of an error of omission. The statement was made for June 1. The coupons on \$750,000 of bonds were due July 1. The statement included all the earnings for the previous five months, but took no account of the interest accrued but not due for those months. When the accountant incorporated in his statement a liability of \$15,625 for accrued interest, the secretary made another vigorous protest claiming that the interest was not a liability until the coupons were actually due, and was apparently not convinced when he was shown that by his method he would load the month of June with the whole burden of the six months' interest, amounting to \$18,750. There were other items which he had ignored, coupons which were due but had not been presented and rent of park property, of which five months had accrued. Altogether the true condition showed a net profit of $2\frac{1}{2}$ per cent per annum instead of 8 per cent, as claimed by the secretary, and the accountant's clients refused to buy. Incidentally, the accountant discovered another

error of principle when he made his report to the agent in Chicago of the New York parties who were negotiating for the purchase of the road, and this time it was a breach of moral principle much more serious than the honest errors of the secretary. He found that the agent while representing the prospective purchasers on the one hand, was on the other to receive a commission from the sellers if the deal went through, and was consequently more than disappointed at the adverse report.

A Common Error.—An error that is quite common is found in the treatment by the home office of sales to branches. It is very convenient to treat a branch as an ordinary customer, and to charge it with goods sent it at the regular selling price, which, of course, includes the usual profit. But by so doing the profits of the home office are swelled beyond their true amount, since the sales are not actual until the goods are disposed of by the branch. There is an instance on record where the manager of a bicycle factory wished to make an especially good showing for the year, and accomplished his purpose by shipping an abnormally large quantity of goods to each of the many branches, billing them at regular selling prices. On the strength of the excellent business thus shown the manager was enabled to sell his stock at a considerable advance, when he resigned and left to the rest of the officers the task of explaining to the stockholders the reason why the business of the next few months showed the marked decline that resulted. If, on the other hand, the goods shipped to branches are billed at cost and passed through the regular Sales Account, the latter account is swelled so as to destroy the basis of percentages of selling expense and of profits to sales, if such percentages are used for the information of the company's officers.

Sales and Expense Accounts.—The best way to handle the accounts is to credit the sales to branches to a Branch Sales Account, whichever way they are billed, for in this way the business of the branches is shown

separately from the regular business and a separate Profit and Loss statement can be made up for them.

When the sales made by the branch are reported to the home office and all collections are made from the home office, the branch becomes a selling agent merely and no accounts are kept with it, except for the Expense Accounts, which are usually taken care of by advancing a definite sum to the branch to begin with and then sending them checks from time to time for the specific amount of the expenses paid to date.

When a proper system of accounts is kept, in which manufacturing is kept separate from the selling expense, it is necessary to divide the Freight Account into in-freight and out-freight. In-freight is unquestionably a part of the cost of the goods and should eventually be charged to it. This is readily seen if we compare an instance of goods shipped F. O. B. destination, where the freight has been allowed for in quoting prices. In this instance the whole cost is charged up without question. There is no difference in principle between goods thus bought and those bought F. O. B. shipping point, except that in one case the buyer pays the freight to the seller, and in the other to the railroad company. And yet, very often there is no distinction made between the two classes of freight.

An error that is sometimes made consists in treating consigned goods as if they were actual sales. There have been cases where very large quantities of goods sent on consignment were passed through the regular sales-book as ordinary sales with nothing to show that they were any different from the rest of the sales. It was not discovered until attention was called to the fact that certain customers had abnormally large charges to their accounts. In the meantime the supposed profit on the transactions had been taken to the Profit and Loss Accounts, and a false credit to that account had been created amounting to thousands of dollars. The only proper way to keep such accounts is to credit consignment sales and charge the consignee in a special Consignment Account. A curious error in principle that is often found consists

in the manner of treating bad debts. It is a very common thing to find these charged to a Suspense Account which is still carried on the books as an asset, and therefore is included in the profits. Many a business man prides himself on his conservatism in promptly charging past due accounts to Suspense, and it is very difficult sometimes to show him that he has done nothing more than to change the name of the account, and has not in any way altered its nature as an asset, unless he has at the same time opened a contingent Reserve Account on the other side of the Ledger.

Inventories a Source of Error.—Inventories are a frequent source of error, and it is difficult sometimes to say just what are errors in this connection, as good authorities are not entirely agreed upon all the points involved. The best authorities seem to unite in saying that nothing should be valued at a higher price than it actually costs. The cost will include all the elements, direct and indirect, that have so far entered into the production of the finished goods or those in process of completion. The practise of listing finished articles at the selling price, less the supposed cost of selling, is common, but can not be depended upon unless some way is found to guarantee the future market price and also the selling conditions. The cost of selling for previous years is not always a safe criterion for the coming months. With a given number of salesmen on the road, or a given running expense in the store, the comparative selling cost varies to a certain extent with the volume of business done, so that a diminished trade would increase the selling cost and impose an additional burden on the current year, that may already be showing bad results, owing to the reduction in gross profits.

A practise that may lead to serious error, but which is frequently defended by manufacturers who indulge in it, consists of inventorying raw material at the market price when that is greater than the cost. It is claimed that the advance in price is a legitimate profit of the year in which it occurred, and the Profit and Loss Ac-

count is given credit for it while it remains as only a possible profit, in case the market does not react before the material is made up and sold. The broad principle should be adopted that no profit can be depended upon until the goods are actually sold, and that in the meantime the material should be carried at not more than the cost. On the other hand, when the market price of raw material has dropped since its purchase the conservative man will carry it at a lower price in the inventory. In other words the advice usually given by the careful auditor is to carry the material at whichever price is the lower. If this is a mistake it is certainly one on the safe side, and if there are any surprises in store for the man who follows it they will prove to be pleasant ones; while the other course may lead to consequences that will be disagreeable if not disastrous.

Reserve Accounts.—Reserve Accounts are frequently confounded with Sinking Fund. The latter, however, has nothing to do with the Profit and Loss Account when the fund is established to take care of bonds or other debts at their maturity. In this case the payments to the Sinking Fund consist simply in a change of assets which are intended eventually to cancel a liability. When, however, the fund is established to take up a wasting asset, such as a lease or a mine, it is a charge against earnings, because the diminishing value of the leasehold or the exhaustion of the mine is an expense of business, and the fund that takes care of it must be derived from profits in the same way that profits have to cover any other item of expense.

A question that involves a very important principle is that of the right to carry a secret reserve. This usually consists of the undervaluation of assets for the purpose of reducing profits at a time when they are large in order to increase them again when they may have fallen off. When a large defalcation in a New York bank was discovered some years ago, it was stated by the officers of the bank that the entire amount could be taken up without charging any of it to the Undivided Profit Account.

A great many persons were unable to understand how this could be done, and only a few were any wiser when they were told that the bank had a large secret reserve.

Secret Reserves.—It appears that the practise of accumulating secret reserves is a growing one, that it is by no means confined to banks, and it is very warmly defended by those who practise it. They claim that it is better to conceal abnormally large profits one year so as to provide against the necessity of showing unusual losses in another year. In the case of a close corporation or partnership, whose stockholders or members know all about the business, there would be no serious objection, but there would also be no special reason for doing it. It would then be about on a par with the practise of the suburbanite who sets his watch five minutes fast so that he may be sure to catch his train. In the case of a company whose stock is somewhat scattered, and may be sold at any time on the basis of the statements furnished to the stockholders, it seems impossible to find any justification for the practise. The seller of such stock is unquestionably defrauded out of the increased price that he could have obtained if the true condition had been known to him and to the buyer. If the buyer happens to be one of those on the inside, with knowledge of the secret reserve, while the seller is ignorant of it, the injustice to the latter is still more flagrant. In the case of the bank mentioned, the one item referred to amounted to fourteen per cent of the total capital. All sales of stock made prior to the discovery of the shortage were based on wrong assumptions to the detriment of the sellers. It is not probable that any one would defend the managing partner of an ordinary copartnership if he deliberately understated the profits, so as to prevent his partners from drawing out a greater dividend than he thought proper. But the presidents and directors of a corporation are simply the managers of a partnership affair, the act of incorporation being for the purpose of limiting the liability, and for greater convenience of action, but not in any other way justifying the company to differ from an

ordinary partnership. The auditor who is acting for the stockholders of a company would not seem to be justified in signing a certificate to a statement which contains a secret reserve, or any other element that is not in accordance with the facts. Not only is he bound to tell all the truth for truth's sake, but he is also under obligation to give the stockholders all the information in his power. Those auditors who take a different view of this question defend their course, on the ground that they are employed by the president and directors of the company, and are not supposed to criticize their management of the business. While it is true that it would be better to follow the English plan, and have the auditors appointed by the stockholders as their special representatives, it does not seem clear that the appointment by the directors absolves the auditor from his duty to the stockholders. Although not made directly to them, his report is, theoretically at least, to be used with the stockholders', and it should be as carefully prepared as if made originally to them, and should contain nothing that would cause any stockholder to form an incorrect opinion as to the true condition of the company.

These examples of some of the errors that are noticed by an auditor are sufficient to show that he has much important work to perform in examining accounts in addition to finding out whether the petty cash may be short a few cents, or the general cash several hundreds of dollars.

The Advantages of an Audit.—The statement that a professional audit is of value has raised a question from time to time as to what advantages may be reasonably expected to accrue therefrom. In addition to those mentioned as coming under the head of the primary objects of auditing, i. e., the detection of fraud and of errors, the possible benefits to be derived include the following:

1. *Condition accurately shown.*—An accurate statement of affairs, together with a profit and loss account showing how this position was reached, is prepared by a disinterested expert.

2. *Bank loans and sale of business.*—There are available certified accounts valuable as a basis for bank loans. All leading bank managers recognize the assistance rendered to them in the course of their business by certified accountants, and even if the client is in the happy position of not requiring occasional aid from his banker, yet his rating is considerably higher from a banker's standpoint if he is thoroughly up to date in the care of his books and accounts. These certified accounts are also useful in facilitating the sale of a business.

3. *Partnerships.*—Partnership books should always be adjusted by a professional accountant if for no other reasons than that he will act impartially and comply fully with the articles of copartnership. These accounts are peculiarly liable to disturbance by causes from which corporations on the whole are exempt. Disputes occur as to salaries, division of profits, partners' overdrawings, inattention to business and many other things which would to a large extent be obviated if the books were regularly audited by a competent outsider. A partner dies and there is trouble with his administrator as to the division and withdrawal of the decedent's capital, in many cases resulting in expensive law suits and the permanent crippling of the business. A partnership goes into bankruptcy, perhaps through misconduct of a trusted partner; had a continuous audit been in force the fraud might have been nipped in the bud. Again, for the protection of a limited or special partner and a silent or dormant partner a periodical independent audit is essential.

4. *Fire Loss.*—In the case of loss of merchandise by fire a properly authenticated balance-sheet prepared by a public accountant is a material aid in the adjustment of claims.

5. *Bonding.*—A cashier whose books are audited regularly has little trouble in securing a good company to act as surety for him, in fact several of the best companies insist, as part of the contract, that this be done periodically.

6. *Protection of Shareholders and the Public.*—The interests of the real proprietors of a business, who in the

case of a corporation are the shareholders, should be protected in every feasible and reasonable manner. One way in which such an end might be served would be to conform in practise more nearly to the English method. There, the stockholders elect at their annual meeting a professional accountant as the auditor of the company for the ensuing year and his report is made to the shareholders and not to the officers and directors. In England and Canada it is compulsory by law that all corporations be audited at least annually. This provision not only has the effect of weeding out the financially unsound company, but also furnishes to bankers, through the certified balance-sheet, a means of establishing a firm basis on which to enter upon business transactions; credit conditions are bettered and enlarged, and commercial confidence increased.

7. *Auditor's Liability.*—It may be pointed out that an auditor, through gross negligence, failing to discover fraud or embezzlement on the part of the employees of a client may possibly be held liable for damages. While no cases bearing on the specific liability of auditors have been decided by any of the higher courts in the United States, the law is well settled in England that auditors may be held for gross negligence. This liability involves, of course, a corresponding benefit to the persons in whose favor it accrues and is consequently a factor to be considered. It is perhaps hardly necessary to add, however, that the auditor does not insure the honesty of his client's employees.

8. *The Moral Aspect.*—Finally, the moral aspect of auditing must not be overlooked. The wholesome atmosphere created among the employees by the lessening of temptation, the increase of business and political morality and decrease of corruption, particularly among civic and municipal officials, the lessened anxiety on the part of employers, and the personal satisfaction and feeling of security of cashiers and other responsible employees, must not be lost sight of in estimating the advantages of an independent audit.

3. METHODS OF AUDITING

In a narrow sense there are but three methods of auditing:

1. An inspection which involves a mere checking of the books and records. The placing of red ink tick marks opposite supposedly like figures in different books, and the verification of footings, vouchers, etc., which enable an auditor to say the arithmetical work is perfect.

2. A mere inspection of results; an analysis of certain accounts.

3. The really proper audit; a combination of the others which necessitates the verification and testing of enough of the clerical work, to assure the auditor of its accuracy, supplemented by a careful analysis of the accounts, by a searching inquiry into the entire organization under inspection, by a careful search for errors of principle as well as for technical errors and fraud, and by an intelligent study of the balance-sheet.

1. Checking and Footing.—Not many years ago one of the principal features of every audit was the inspection and verification of vouchers for cash payments. It seemed conclusive to many people that if a cashier or treasurer could furnish a voucher for every item of cash disbursements there could not be anything wrong about the accounts as a whole. As the science of accounts developed some auditors were not satisfied with this and the examination of the vouchers was supplemented by a complete verification of the footings and postings; the checking of the trial balance added to the above covered the full program of a large percentage of audits at that time.

It will have to be a very small business indeed, to-day, where there can be a justification for verifying every posting, every footing, and examining every voucher. An actual analysis of various defalcations which have occurred in recent years demonstrates the fact that the percentage of frauds which have been concealed by false postings and incorrect footings is small, and may be

covered just as well in what may be called a "test" audit as in a "detailed" audit.

2. Inspection and Analysis.—Auditing by mere inspection of results or analysis of accounts is the method adopted in examinations on behalf of prospective purchasers of a business. The client in such cases desires a statement of profits covering a series of years; he wishes this information to be submitted to him as quickly as possible and is not vitally interested in the bookkeeping methods in vogue unless they seriously hamper the accountant in obtaining the required knowledge. An audit professes to discover the true position of affairs; an examination as to profits, however, professes to show the same thing only in so far as the particular object in view is affected. Thus, supposing the auditor to be acting on behalf of intending purchasers, he may take it for granted that the accounts submitted to him by the vendors do not underestimate the profitable nature of the business or the strength of its financial position. Consequently it does not seem necessary that he should inquire with the same exhaustiveness that he would use in the case of a regular audit into the completeness with which every source of income has been duly accounted for; neither does it appear necessary for him to consider the validity of the various items of expenditure charged in the accounts nor to check such expenditure minutely with the vouchers. An ordinary audit must always aim at the discovery of fraud, but an examination into profits would not appear to involve any such inquiry except in so far as the assets or profits might have been fraudulently overstated for the purpose of concealing defalcations, or of deliberately making the accounts appear in a more favorable light than they would warrant.

3. Verification and Testing.—With reference to the really proper audit, the first thing to be considered is: What is an intelligent and exhaustive test of footings and postings? The majority of these occur with respect to the following:

- (a) Purchase Records,
- (b) Sales Records,
- (c) Cash Receipts,
- (d) Cash Disbursements,

and if a proper test be devised the remaining records may be left to be dealt with on their merits. The fundamental principle, that no audit is complete unless the trial balances of all the ledgers have been proved, must of course obtain, regardless of the extent to which postings and footings are verified.

(a) Purchase Records.—Seldom, if ever, will there be any concealment of fraud through manipulations of postings and footings with respect to purchases; if fraud exists it will be found usually in overcharges or the use of the names of fictitious creditors. The postings of the monthly or periodical aggregates must be verified, and in addition the footings checked of, say, every fifth or sixth page, in addition to the last page of each month of the posting mediums where the audit covers an annual period.

(b) Sales Records.—If there is a controlling account with customers in the general ledger it will not be necessary to verify in detail the postings of the customers' dealings; if no controlling account is maintained one should be constructed. Accounts receivable are a prolific source of fraud, which consists not in a failure to post the items recorded in the sales books, but in omitting the sales from the records entirely or failing to enter cash collections. The monthly or other totals of the sales postings should be checked, and thus through the controlling account, supported by a verified trial balance of the subsidiary ledgers, the individual charges are proved. As to the footings the auditor should feel a little more apprehensive than with purchase records, verifying every third or fourth page and always including the two last pages of each month.

(c) Cash Receipts.—In well-regulated concerns all cash receipts are daily deposited in bank and all pay-

ments must therefore be made from the bank account. Where the bank account is proved and the cash receipts and payments are traced into and out of the bank it would seem logical that the footings of the cash book could automatically be proved at the same time; should this, however, appear not to be sufficient verification, the footing of every other page in addition thereto affords a complete check. Sometimes a part of a plant or old machinery may be sold and such items posted to an earning account instead of to a capital or reserve account; to locate such errors of principle it is necessary to verify the postings to the nominal accounts. Credits to customers should be proved in totals through the controlling accounts; where no controlling accounts exist, a fair test of the individual credits is made, working, of course, from the ledger to the cash book and not vice versa. The reason for this is, that if a customer has been credited with an amount which purports to have been posted from the cash book, but which is not entered there at all, it would not be discovered by using the cash book as a basis.

(d) Cash Payments.—The auditor should insist, wherever possible, on having all payments represented by checks. It reduces the possibility of manipulation of cash-book footings to a minimum. The footings, if proved with the bank account, need not again be verified. If the cash book is properly columnized and a controlling account kept for accounts payable, most of the postings will consist of monthly totals, which should be checked to see that they get into the proper accounts. The payments are vouched to establish their authenticity, and it is not necessary to trace same to the debit of the individual accounts unless some special reason appears.

The treatment of postings and footings herein outlined may seem radical but it has stood the test of full discussion and thought, combined with actual practise.

Vouching.—This is a process by which the auditor goes behind the books, and while it frequently discloses unintentional errors it may also bring to light fraudulent

dealings carelessly concealed. The value of this process lies in the fact that vouchers generally furnish evidence from sources wholly outside the business under review, and it is the aim of the auditor to revert to the origin of the transactions. Vouchers, moreover, give the auditor an insight into the nature and scope of the business, which no mere inspection of the books would furnish. It is no common thing to hear a voucher defined as a receipt; this is a fallacy, for a voucher may be anything besides a receipt, and a receipt in itself is not the most effective voucher. Taking therefore a broad view, vouchers may be said to fall under three distinctive heads: (1) Descriptive, (2) Authoritative, and (3) Conclusive. It is quite possible that all three functions may be combined in one voucher, but more generally one document usually unites the first two and the third appears on a separate document and under a different date; frequently the authority is not shown on the descriptive voucher but appears on more permanent records.

(1.) *The Descriptive Voucher* is a document written in full detail, and shows clearly the nature of the transaction. It may be an invoice for goods purchased, or services rendered; and emanating from an independent source it is valuable to the auditor.

(2.) *The Authoritative Voucher*, which may be combined with the descriptive voucher, is an authorization of the latter and emanates from a source within the business; it is important that the auditor be assured that the person purporting to approve documents has that power invested in him. There should be some evidence of the voucher having been checked and examined as to details and calculations, and in addition the initials of some one responsible for the transaction as a whole. The auditor will judge of the value of the authorization from the nature of the document itself and in some cases will require it to be passed by the highest authority.

(3.) *The Conclusive Voucher* is so called because it is intended to describe those documents which form the conclusion of the whole matter, when the transaction has

been duly entered after authorization and now finally disposed of by a cash payment. If a check bears, on its face or back, any indication of its purpose it is the best receipt for money than can be secured; if it bears no evidences of its purpose, but can readily be identified with a particular bill or invoice, it is still a better voucher than a receipted bill. A mere receipt for so much money is poor evidence of a legitimate payment, but a paid check properly indorsed and otherwise identified as representing a definite liability is pretty fair proof that the money has reached the creditor.

The auditor is ever on the alert to guard against the possibility of duplicate invoices being entered upon the purchase records. Frauds have been frequently committed in this connection by the simple process of writing up the duplicate invoices as rendered; checks for the excess amount so credited would then be drawn in the usual manner and the amount regularly charged, so that the balance due the creditor would appear to be accurate; a manipulation of the receipts completed the defalcation. To prevent the production of a document a second time, the auditor cancels by means of a punch or special stamp all vouchers passed by him.

It needs little demonstration to show that an auditor who sets out to examine and vouch the entire business of a large concern thoroughly and exhaustively has before him a stupendous task, hence it is that under certain conditions he is justified in dispensing with some of the work. To do this, he must, by close observation and careful inquiry, satisfy himself that the system on which the accounts are based and the distribution of work in the office are such as to prevent error on the one hand, and fraud and defalcation on the other. A complete system of internal check (see p. 344) should be required and evidence shown in the books and on the vouchers that it is being carried out. If the extensions and calculations on invoices and similar documents have been examined by a careful clerk, the auditor may reasonably leave that work untouched.

If at all practicable, however, the purchase register is

vouched by the auditor on account of the very composite nature of the documents connected with it, and with a view to distribution under proper captions. Otherwise, subject to a sound system of internal control the auditor might be satisfied with generally glancing through the invoices and indiscriminately selecting certain items to be checked. It is usually quite feasible to vouch cash disbursements and it is important that the correct disposal of cash should be ascertained. Petty cash payments are so frequently manipulated and the vouchers supporting same altered that a much better protection is to have some responsible person scrutinize the petty disbursements, rather than the vouchers themselves, and indicate his approval by writing in a special ink the total for each page or month, together with his initials. Of course where it appears from a partial examination that there is ground for suspicion, nothing short of exhaustive vouching will suffice to satisfy the auditor. But however partial the inspection of vouchers may be in regard to the ordinary business of a concern, the balance-sheet must always be amply supported by reasonable evidence.

Verification of Income.—When the audit is completed the accountant should be able to certify that in his opinion all revenue has been accounted for. This does not mean that the cash which was duly entered in the cash-book and the sales entered in the sales-book were assumed to be all the cash receipts and all the sales without further investigation. It is very important to ascertain that all cash sales are accounted for. In nearly every business some sales are collected at once and are not passed through the customers' ledgers. A thorough inquiry will reveal whether or not cash sales have been made, and even where the bookkeeping is loosely done, usually a memorandum of such items may be found. Original records of sales and shipments, considered no part of the general system, have disclosed perhaps more instances of fraud than any other source.

The auditor secures the order books and compares some of them with the ledgers to see that the orders were

filled. If not, why? Perhaps through carelessness the order was overlooked; again, orders may have been filled, and the customer not charged; this would come to light by a comparison of the shipping records with the sales records and the ledgers; or, the proceeds of sales may have been collected but not accounted for; the best way to detect such a defalcation is for the auditor to send out statements to all customers, who are requested to confirm direct to the auditor the accuracy of the balances on a blank enclosed for the purpose. This is the practise of many leading auditors; clients sometimes will not consent to such a course, in which event the auditor is obliged to decline to be responsible for the integrity of the customers' balances. The practise is growing, however, and within a few years the verification of such items by correspondence will be the rule rather than the exception.

A fruitful source which aids in verifying income is the trial balance taken after the books have been closed; each item is given proper thought to determine the possibility of income therefrom being omitted from the books. For example, in a large manufacturing company whose books show that it owns workmen's dwellings, it will be necessary to find out if all the rents from all the houses have been turned in; in such a case a general store may be operated by the company, and coal, fuel and other supplies sold to the tenants; the auditor will verify the receipt of moneys from these sources and if no record of such appears he will immediately be placed on inquiry and will obtain the information he desires from a high official and supplement it by a visit to the workmen's homes. Another instance is a firm or corporation which has invested part of its surplus in bonds or stocks or some other outside venture. By inspection of these items the auditor can readily determine the amount of income which should have been received and can then see if it has found its way into the bank. By thus working from every possible outside source to the cash-book, in addition to the facts contained in the books, the auditor is reasonably assured that nothing has escaped his attention in the verification of income.

Proving the Balance-Sheet.—The auditor will determine whether or not an audit directed principally to transactions prior to and leading up to a balance-sheet will be of greater value to his client than an audit which very largely takes for granted the integrity of the current operations and in which the chief interest devolves upon the assets and liabilities—do they correctly represent the true financial position at a certain date? The latter is a balance-sheet audit so called. Where there is an auditing department properly conducted, or where the purpose of the examination is to determine the net worth of the concern, the auditor will usually confine himself entirely to the items of the balance-sheet. In an examination of this kind, as indeed in all audits, his attention will be chiefly directed to ascertain:

1. That all of the assets shown by the books to have been on hand at a certain date were actually on hand as stated.

2. Whether any other assets not on the books should have been on hand.

3. That all the liabilities shown by the books to be owing at a certain date were actual liabilities.

4. Whether there existed at that date any liabilities other than those entered on the books.

5. Whether the liabilities were properly incurred.

6. Whether the earnings shown by the books were properly accounted for, and whether any of the earnings were omitted therefrom.

7. Whether the expenses and losses were properly stated and supported.

Verification of Assets.—The cash on hand is, of course, subjected to a physical verification, but the balance at the bank may be proved by a certificate obtained from that institution. The valuation of inventories is outside the scope of an auditor's duties, but he must assure himself that the valuation has been made by responsible persons. The authoritative documents here are the detailed inventory sheets, certified as checked and examined, and authorized by high officials of the company. The exami-

nation of Bills Receivable requires a knowledge of commercial paper and the laws affecting it. All overdue or protested notes should be transferred immediately to the personal accounts of the debtors. Accounts Receivable can usually be valued without difficulty. If the business has been established for some years, past results can be used to advantage and, based on this, an allowance for doubtful debts can be ascertained; bad accounts should be written off the general books and carried to a memorandum ledger so that any ultimate realization thereon may be noted. For investments of all sorts, the auditor requires to be produced the appropriate certificates and through the use of common sense and his every-day knowledge of the market he will be able to detect quickly false values placed thereon; if the investment be real property vouchers are required which take the form of deeds and similar legal documents. The auditor will not accept the book values of Plant and Machinery and other fixed assets as final. He will, if possible, ascertain exact book costs and apply proper depreciation, or retain a competent appraiser to revalue the assets. A careful analysis of the nominal accounts will disclose all prepaid items such as rent and insurance, and a careful inspection of the assets will reveal accrued items like interest and dividends receivable; such assets, if they exist, should be placed on every balance-sheet.

Verification of Liabilities.—The audit of the liabilities is not of less importance than the verification of the assets. This aspect of the examination demands that great care be taken, as liabilities are more often omitted from the balance-sheet than assets. The usual items of liabilities are accounts and bills payable, bonds, mortgages, revenue collected in advance of being earned, such as interest on unmatured notes held by banks, subscriptions paid in advance, etc., and accrued expenses.

As regards Accounts Payable, the most frequent error in practise is one of omission, and consists of goods actually received and included in the inventory of stock on hand not being entered in the books during the same

fiscal period. Where a good system of stock accounts is in use or a method of checking back goods received with the purchase book or the invoices themselves this is not so liable to occur, but in a concern where neither of these systems obtains, especial vigilance is needed on the part of the auditor to satisfy himself that no bills have been omitted. The auditor verifies the accounts payable by calling for the vendors' monthly statements, and as he compares them with the ledger he scrutinizes carefully any bills appearing on the statements but not on the books as to both the date of the bills and the date of the receipt of the goods. Unpaid notes, per the Bills Payable book, are totaled and the aggregate compared with the ledger account. In the case of collaterals being pledged with the loans, the holders are communicated with for confirmation of the loans and definite statement of the security therefor.

In the matter of Bonds and Mortgages the minutes of the concern are consulted for authority bearing on their issue, rate of interest, etc. The bond and mortgage are read through to see what provisions regarding sinking funds, redemption, etc., may be contained therein, and further that these provisions are being carried out.

The auditor keeps a sharp lookout for contingent liabilities; they sometimes become direct and very live liabilities in short order; instances of contingent liabilities are bills receivable which have been discounted, accommodation paper, etc.

Examination of the books and records pertaining to the issuance of capital stock should at least extend to the checking of the stock ledger trial balance and inspection of the stock certificate stubs and preferably also the transfer records. As with the issuance of bonds, the minutes should be examined for any action relating to issuance, retirement or exchange of capital stock, as well as for authorization of officers' and managers' salaries. The articles of copartnership in private firms are examined for the provisions relating to the investments to be made by the several partners, interest on capital and on withdrawals, partners' salaries, division of profits, etc.

After he has finished the audit, as herein generally described, which has satisfied him that the earnings have been properly accounted for, that no revenue has been omitted from the books, that the expenses have been properly supported and that the balance-sheet represents the true condition of the concern on the date specified, the auditor is ready to render a clear and concise report to his client.

4. SCOPE OF AUDITING

Audits are not restricted to a few lines of business or even to commercial life. In addition to examining the accounts of financial institutions, mining, manufacturing, and mercantile enterprises, transportation and public service corporations; and scrutinizing the affairs of educational and philanthropic institutions, and of municipalities and States, public accountants are now called on to act as receivers, trustees, and administrators, for which duties by their intimate acquaintance with business procedure they are eminently qualified.

In the foregoing pages the procedure outlined has been as general as possible, but it must not be supposed that every audit is conducted on precisely the same lines.

The opportunities for fraud will vary widely in concerns of a different character, while the chances of unintentional errors of principle and detail will likewise change considerably in different industries. In the following paragraphs it is the intention merely to indicate the points most worthy of the auditor's attention in a few undertakings, and not to outline a comprehensive audit.

Wholesale Merchants.—The chief openings for fraud in these accounts are: Theft of stock; misstatement of cash sales; fraudulent payment of bogus purchases; misappropriation of moneys received in payment of accounts—such accounts being either left open or written off as *bad*; petty theft by the raising of fictitious items of discount allowed on receipts, or interest incurred on payments; and similar matters. Of what may be styled

innocent errors, the most common are errors of principle in the valuation of stock in trade; insufficient depreciation on furniture and plant; omission to allow for outstanding discounts and interest; errors of principle in the valuation of foreign currencies; omission of liability on outstanding expenses, and on notes discounted; insufficient provision for bad debts, etc.

Manufacturing Traders.—Under this heading are intended to be included those manufacturers who ordinarily keep a stock of ready-made articles, and who do not manufacture exclusively (or principally) to order. What has been said above will also apply to the consideration of these accounts; but a few additional precautions are required in connection with the manufacturing department.

The item of wages, in particular, is one requiring the utmost care; and the question of depreciation of plant and machinery will also require a full share of attention. A proper system of cost accounts becomes all but essential. It is probable that the auditor will find some such system in operation; but it is at least equally probable that the actual system employed will be found both unscientific and unreliable.

Retailers.—Retailers who give credit in many respects follow upon the same lines as the wholesale houses in the same trade; but the increased number of transactions renders a detailed audit more difficult. It is generally quite impossible, and in nine cases out of ten entirely unnecessary, to call back all the postings of the sales ledgers, but the balancing thereof can be checked without difficulty, and must always be done.

The vouching of cash received—whether for cash sales or sales ledger accounts—may, under a good system of internal check, safely be left to the care of the client's staff; but it is the auditor's duty to see that the receipts are duly deposited and to verify the bank balance. A large retailer's audit will, almost invariably, be continuous; and it is desirable that the bank balances, and also that of the petty cash, be examined at least once a month.

The examination of petty cash has already occupied attention, and it therefore only remains to repeat that—in addition to vouching for the good faith of all payments—it is essential that some responsible person be made accountable for the correctness of the analysis of the items.

The department accounts must not be lost sight of, as they form one of the most important branches of the auditor's duties. An account showing the sales, purchases, and estimated stock should be submitted to the officers or proprietors each month, and the preparation of this account frequently devolves upon the auditor. At the stock-taking the reconciliation of the estimated figures with the actual stock on hand may also profitably occupy the auditor's attention.

In cash businesses the problem is somewhat simplified by the considerable reduction effected in the number of sales ledger accounts. Indeed, these accounts are, of course, naturally abolished in name, but they remain in essence—as for instance, deposit accounts kept by regular customers who wish to avoid the trouble of remitting with every order. It is an important part of the auditor's duty to see that deposit accounts are never withdrawn without proper authority and that the interest credited is at the rate agreed upon.

It is usual for credit notes to be issued against goods returned by customers; and, as these credit notes may be used in payment of subsequent purchases by the customers, or the money therefor obtained upon application to one of the cashiers, the question has to be dealt with by the auditor. It is generally arranged that, at the end of the day, the petty cashier will redeem all credit notes in the hands of the receiving cashiers, the amounts being charged up through petty cash. The issue of credit notes must, therefore, be carefully guarded against abuse; and it is essential that the system under which the various departments are debited with their respective returns be properly arranged. The credit notes should always be compared with the stubs, and presented to the auditor for cancellation. Failure to cancel credit notes properly has in several instances been responsible for fraud, which

has been effected by a dishonest employee securing possession of and recashing them in other and secret channels.

Contractors.—In these accounts the cost of, and profit or loss arising from, each contract will require to be separately stated; the contractor, in fact, opening a special trading account for every contract. Cost accounts thus form an especial feature of the contractor's books, and an inquiry into the principles upon which they are based is thus a most profitable occupation for the auditor.

The systems upon which stores are issued, time records written up, and wages calculated and paid, are also of the greatest importance; and time spent upon such an inquiry is likely to be of considerably greater advantage to the client than any detailed examination of the books.

It is also important to call for the monthly statements from the subcontractors, who will frequently be found to have large claims for extras which do not appear to their credit on the contractor's books. Probably the contractor has billed the owner for these identical items and passed all the various amounts to the credit of the contract.

Frequently it will be found that an agreement has been made with the subcontractor to pay him for the extras only in the event of the contractor being successful in collecting, but the books in the meantime show a credit to the contract which must not be carried to profit and loss, and which, therefore, should be offset by a reserve sufficiently large to cover all such items and also for such further claims as the subcontractor may have, which may not be passed upon or which have not been allowed for various reasons.

The extent of the auditor's examination into details will be a matter depending largely upon the nature and magnitude of the undertaking. A detailed audit would not usually be necessary, as the main points could generally be accomplished by an examination of the general ledger; in any case the leading principles will be the really important matter.

Breweries.—Theft of stocks and of collections are, perhaps, the two main risks run by brewers. The former is best guarded against by properly designed stock accounts, and the comparative statistics deducible therefrom, combined with a certain amount of practical knowledge—which latter the auditor will most likely have to take upon trust from the master brewer. The second risk arises from the fact that customers' accounts are frequently collected by the drivers; the matter therefore requires great care, but it presents no exceptional features. The discounts shown must not be passed without inspection, however, as they can easily be altered in various ways.

In connection with saloons controlled by the brewery, the auditor should see that all the revenue receivable from this class of investment is brought into the account, subject only to due provision for bad and doubtful debts. In most cases loans will be due from the tenants, and in connection with these loans provision against loss is a matter of considerable importance, and one requiring the most careful consideration. It should, moreover, be borne in mind that the limit of possible loss in most cases greatly exceeds the amount actually advanced, inasmuch as the brewery will sometimes have guaranteed a loan obtained by the tenant, which forms a first charge upon the property. The aggregate amount of such guarantee should, it is thought, be stated upon the balance-sheet as a contingent liability.

Another point of considerable importance is the question of depreciation. In the case of a brewery plant, the actual wear and tear is probably less than in the case of most undertakings, because the plant will not be working every day, and thus—apart from the fact that it is running a comparatively small number of hours per week—the intervals of rest afford facilities for making satisfactory and permanent repairs to a far greater extent than is practicable with most other undertakings. The result is that a brewery plant can in practice be kept at a very high state of efficiency by careful and reasonable repairs and renewals. On the other hand, some items are espe-

cially liable to depreciation by becoming obsolete, and this important fact should be kept constantly in mind.

Hotels.—The auditor who is accustomed to hotel accounts will be able, by a careful examination of the items comprised in the profit and loss account, to form a fairly reliable opinion as to whether or not any leakage exists. If there appears to be any reason to suspect that things are not as they should be, it might be found desirable to thoroughly examine in detail the charges for a portion, at least, of the period under consideration, but, under ordinary circumstances, it is not usual to carry the investigation behind the guests' ledger, except for the purpose of verifying the wine-room stock books. Proper stock accounts ought always to be kept of wines, liquors, cigars, etc., and these should be carefully inspected, especially if the profit and loss account does not show an adequate return on this department. Where the book-keeper is also the cashier, especial care must be exercised to ascertain that all receipts are properly accounted for; and it is also important to see that the petty cash disbursed upon behalf of guests has been duly charged to their accounts and collected. The entries in the purchase and private ledgers should always be thoroughly checked; and special care should be given to the vouching of all payments, including wages.

Club Accounts.—In the business of a hotel it is, of course, practically impossible for the proprietors to rely upon their customers to assist them in any way in checking their employees; but, in the case of clubs—and particularly clubs where the members themselves are the proprietors of the undertaking—the accounts can be somewhat modified to advantage, with a view to devising a system by which the members themselves may, to a certain extent, check fraud upon the part of employees.

Numerous instances have been disclosed where the members' dues have been misappropriated, and this has usually happened where the payments were in currency. It is a good plan, therefore, to print a request on the bills

to members to pay same by check to the order of the club. It is also advisable to request the members to pay their house accounts in the same way; and as it is becoming the custom of many clubs to require all payments to be made at the office, very little difficulty should be experienced in enforcing the rule of payment by check.

In connection with the bar, also, the accounts of clubs present an advantage over those employed by many hotels, viz., that all orders for drinks have (frequently) to be signed by the member, and are thus available as vouchers for verifying the taking of wines and spirits out of stock. It may be added, however, that this is a system which is used by a considerable number of hotels, although many dispense with it on the ground that it is difficult to get their customers to take the necessary trouble. In clubs, where the orders or tickets are returned to the members monthly after payment of their accounts, carbon sheets are frequently used and duplicate orders obtained.

Another system is that of ticket books; everything bought by members to be prepaid therefrom. It saves bookkeeping—no personal accounts being necessary—and has much to commend it.

Theater Accounts.—The most difficult feature in theatrical and similar accounts (from the auditor's point of view) is the large amount of cash—i. e., currency and coin—which is necessarily handled by all persons connected with the financial part of the management.

It is not usual for the auditor to be expected to verify the cash takings; this is usually performed by the treasurer, who is considered a sufficiently responsible person for the performance of a function that requires integrity certainly, but no great technical knowledge.

The audit of theater accounts is a simple matter, and is made somewhat as follows: The auditor counts the coupon tickets in the rack and deducts the number on hand from the total capacity of the house; he secures a statement of "hard" tickets furnished the treasurer at the beginning of the season, deducts the number on hand at

the time of balancing, and the remainder must be accounted for in cash. The total result should then agree with the cash and the vouchers in the hands of the treasurer.

He sees that all nightly statements during the period covered by the audit are signed by the treasurers of the companies, compares contracts with managers' settlements to ascertain that receipts have been properly divided, and that the proper shares of "extras" have been collected from companies.

He calls for properly authorized vouchers for all payments. The vouching of payments resolves itself upon the lines ordinarily adopted in trading concerns; and here, as elsewhere, it is not the least important of the auditor's functions to inquire into the manner in which the pay-rolls are prepared. It need hardly be stated that all persons entering the premises before a performance sign an attendance book kept at the stage door for that purpose, and that fines for absence or lateness are arrived at from that source. It is not usual for the auditor to verify the composition of the pay-rolls, but there would be no harm done if he did so occasionally—and unexpectedly.

It will be easy to suggest improvements in the methods generally found in force, but it will be almost impossible to secure any changes. One of the greatest difficulties in theater accounting is to divide the responsibility of the treasurer and his assistant. They both have access to the same cash, and, as it takes an expert at least an hour to count a rack, it will be seen that one can not balance to the other as hotel clerks do when they change watch. The same difficulty arises in connection with the weekly payments to the manager. After making settlement with him, the cash remaining represents the advance ticket sales, which, of course, should be verified at the time. Owing to the difficulty of counting a large number of tickets, managers seldom do it, and more than one defalcation has been carried along by means of using the proceeds of advance sales to cover up shortages.

In continuous performance houses most of the ad-

missions are strip tickets, which are, of course, easily counted.

Publishers.—The audit of publishers' accounts presents a peculiar combination of complications. In many cases publishers do their own printing, and in this respect they follow the rules of manufacturing traders. Almost invariably, however, they are also retailers, and hence the considerations detailed under that heading will also apply. Many houses add the further occupation of trading, either wholesale or retail, or both, in the publications of other firms, which, to a great extent, brings them under the heading of "Manufacturing Traders," while almost every house will occasionally undertake the publication of authors' works upon such terms, as to royalty, etc., as make it absolutely necessary that both stock accounts and cost accounts should be carried to perfection. In this respect publishers' accounts involve many of the considerations discussed when dealing with contractors' accounts.

A complete audit of publishers' accounts is, on account of the multiplicity of detail involved, a practical impossibility; the extent to which a partial audit may advantageously be carried must, on the other hand, of necessity, vary with almost every individual case. The considerations involved in the previous paragraphs are the only ones that can be offered; but it may be added that here—as in the case of all other partial audits—the precise routine may be varied from time to time with the greatest advantage.

Newspapers and periodicals present several special features. In the absence of a staff auditor, the auditor will satisfy himself that every advertisement is paid for—unless, of course, a bad debt has been made—or else that it has been franked by some responsible person. The commission accounts of agents and canvassers should always be examined.

In the case of a monthly magazine, at least two numbers out of twelve should be selected and checked thoroughly to see that every advertisement is accounted for.

A certain portion of the contracts should also be checked into the advertising register, as it very often happens that this book is kept by a clerk in the advertising department who does not appreciate the importance of accuracy.

The subscriptions will be more difficult to verify. Usually, however, great care is taken to secure a good internal check, and the system should be looked into carefully. It is needless to say that the clerks in charge of the subscription cards and records should not have access to the cash. The balance-sheet must, of course, contain a reserve for unfilled subscriptions, although most publishers do not provide such an account of their own accord.

The *inside* of a paper is the work of the regular staff, or of contributors; the former are usually paid a regular salary, the latter are paid for the actual work done. It would be a desirable thing to make sure that a contributor was never paid for a subeditor's work, but no auditor could ever ascertain such a thing for himself, and he must therefore rest content with the certified contributors' accounts as they are submitted to him.

The number of copies printed, issued, returned, exchanged, distributed free, and in stock, should always be certified by the publishing manager. From this return the individual ledger debits may be vouched. The post-office returns or vouchers for second-class postage are a good check on the total circulation.

Mining.—The services of an auditor are frequently required in connection with gold, silver, copper, and other mining enterprises. Usually the services consist in ascertaining for dissatisfied creditors or stockholders just where the cash capital has been sunk, in which case it is of the nature of an investigation rather than of an audit. It sometimes happens, however, that ore is actually found in paying quantities, and the question then arises as to how far the mine manager's accounts can be accepted. He usually remits periodically a statement of his receipts and payments, which is incorporated in the accounts kept at the head office. Such accounts are not usually very

voluminous, and are generally examined by the auditor in detail. It is, of course, desirable that all expenditure at the works be properly vouched for, and that the auditor examine the vouchers.

For balance-sheet purposes the mine manager should be required to apportion all expenditure between capital and revenue, and to certify such apportionment; also to submit a certified statement of local floating assets and liabilities, or a certificate that no such assets or liabilities exist locally, and at the same time he should report upon the state of efficiency of the plant and machinery, together with any buildings and other more or less permanent assets owned by the company. This latter report is most essential for a proper consideration of the question of depreciation.

It is always well for the auditor to use every available means of ascertaining that credit has been given in the books for the value of the whole output.

The wages paid by mining companies require the same careful attention that must at all times be accorded to this very important item; but inasmuch as the greater part of wages paid is at the rate of so much per ton, the aggregate amount payable can be tested with greater facility than in many other cases.

The peculiar conditions pertaining to mine accounts generally render it desirable that the audit should go into considerable detail; concerning the actual extent of such detail, however, no general rules can be given, as each case must be judged upon its own merits. Great care should be taken to see that no expenses are capitalized that are not really of a capital nature.

Banks.—A bank audit is very much like any other audit, and the same careful study of a bank's statement, which an auditor must pay to the balance-sheet of a manufacturing concern, will indicate to him the scope of the audit.

Under our National Banking Act, compulsory examinations are made by examiners in government employ; and while in the past they have rendered invaluable

service, and while many of them are auditors in the highest sense of the word, it must be remembered that their chief duty is to see that a bank is solvent and complying with law, and this accounts for the large number of minor defalcations which they never discover. Owing to the insufficient time which is allotted to each bank, it is a physical impossibility for them to cover the ground thoroughly; and it is no longer a rarity to hear of bank defalcations which have been going on under the eyes of the National Bank Examiners for from twelve to fifteen years.

For these reasons, bank directors are gradually coming around to the feeling that it is their duty to have more thorough audits, and naturally the work falls to the certified public accountant.

The certification of a bank balance-sheet involves the thorough examination and exhaustive testing of every account in the general ledger, the counting of the balance of cash in hand, the examination of all notes, especial care being taken to note that all overdue notes are properly accounted for, and the inspection of all securities—whether owned by the bank or held as collateral for borrowers. With regard to the counting of the cash balance, the only safe way of dealing with checks in hand is for the auditor himself to forward them to the clearing-house and other agents, or where this is impracticable, to secure direct confirmation of the clearing-house returns. The disregard of this precaution has left the door open for most serious frauds upon the part of bank managers and others.

The work of counting the cash and examining the securities can be begun by taking up the reserves first, and working down to the settlements. The staff should be distributed and instructed so that any transfers from one teller to another, or sending outside for cash to conceal a defalcation, would be immediately detected and rectified.

The examination of demand loans and collaterals therefor is one of the most important branches of the work. Extensive defalcations have been covered up by the failure

to endorse partial payments on the notes; the only way to ascertain the correctness of these loans and collaterals is to send out a memorandum to each borrower setting forth the amount of loans and collaterals held at the day of commencing the audit. The confirmation, should, of course, be returned direct to the auditor.

The accounts with other banks will have to be verified by correspondence, and these confirmations should also be directed to the auditor's office and not to the bank.

How far the auditor should extend his examination of the depositors' accounts is a matter concerning which considerable difference of opinion obtains. The ideal way would be to have all pass-books called in at once, and have them balanced by the auditor's own staff. It is, of course, practically impossible to do this, but it is of the utmost importance that as many be examined as possible. The auditor should keep a list of the books inspected, and in the course of a few years the entire list of customers might be covered.

The auditor should see that a proper internal system of checking the balances prevails. It is now customary in large banks for all pass-book balances to be compared with the ledgers and initialed by some one other than the bookkeeper before they are handed to the customers; and in some banks customers are requested to fill out and return a memorandum confirming the balance.

In dealing with bank accounts, and all other accounts of a similar nature, the auditor's responsibilities are not confined to safeguarding the interests of the proprietors; his certificate is virtually—whatever it may be legally—a guarantee to the public that the accounts submitted are to be relied upon as being in every respect correct. It is not, of course, suggested that he guarantees the safety of the customers' deposits; but he would reasonably be blamed were it to transpire that a bank which he had certified as solvent was afterward discovered to be hopelessly insolvent.

Executors' and Trustees' Accounts.—It will sometimes happen that the professional accountant is called upon to

audit the accounts of executors and trustees, on behalf of some dissatisfied beneficiary, or, as is more frequently the case, he will be called in by the executors or trustees themselves, because they desire the certificate of an independent auditor to the effect that their accounts are correct.

The purpose of the auditor's investigation in such cases is to ascertain that the terms of the will or trust have been complied with, and that no improper use or unauthorized investment of the trust funds has occurred. Questions of apportionment between capital and income will also claim his attention.

The fullest investigation into details will be necessary, except, perhaps, that where the trustees have been authorized to carry on the testator's business, and where there is no suggestion that their conduct has, in this respect, been improper, the business accounts may be excluded from inquiry.

In addition to the will and probate, and the accounts kept by the executors and trustees, the probate account (with any subsequent corrective accounts) and residuary account, together with the minute-book (if one be kept) and all documents and vouchers, will require to be carefully examined.

The investments authorized for trust funds (subject to any special terms in the will) may have varied from time to time. The auditor will therefore require to satisfy himself that each investment was a proper one at the time it was made. The investments authorized by the several States vary as to their character, but usually consist of first mortgages upon real estate, Government and first-lien railroad bonds.

Accounts of Public Institutions.—Under this head may be included the accounts of hospitals, certain endowed universities and schools, and similar institutions.

The distinguishing feature of most charities' accounts is the receipt of subscriptions and donations. These will, of course, require to be vouched in the usual way; but, perhaps, the most effective check consists in the publica-

tion of a list of subscribers and donors along with the accounts.

In the case of hospitals there will be a considerable revenue from patients' board, etc., which will have to be carefully checked. It is not always the custom to keep these accounts upon a double entry system, and abuses frequently occur.

There is no reason why the patients' accounts should not be as carefully kept and easily checked as the accounts of guests in a hotel. There is always a Patients' Register, giving time of arrival, etc., and the other books can be arranged conveniently to allow of a satisfactory audit.

In some States where State aid is given to hospitals and other charities, an official auditor visits the recipients and audits the accounts. It is the custom, however, for these officials to simply satisfy themselves that the State's appropriation to the particular institution has been properly expended, without regard to other sources of income and expenditure, and the books are, as a rule, arranged for his convenience.

It is needless to say that such a system does not lend itself readily to the preparation of proper income and expense accounts. On the whole it will be found advisable to continue whatever forms the State examiners may require, but in addition there should be installed a proper system which will show the actual results of the operation rather than a simple cash account.

The vouchers will probably be in very fair shape, as it is customary to have them examined, not only by the State examiners but by committees of the Board.

Colleges and Schools.—These accounts call for but little comment. The usual method of audit may be said to consist of a *cross* between that employed in charities and hotels, but it may be added that only a detailed audit is likely to be found entirely satisfactory.

The income from tuition fees, room rents, etc., forms a large aggregate as a rule, but is usually recorded by single entry methods, and it, therefore, will bear careful check-

ing. Obviously, every student's name found in the annual catalogue must be accounted for, and it is sometimes found to be a good plan to report to the trustees all allowances and rebates, and the names of all free students. It may serve as a surprise to the Deans, but the Trustees will probably appreciate the report.

Most of the balance-sheets of income and expense accounts are made in such an involved way that it is hard to gather any definite information as to the actual results of the operations. In view of the immense sums which are contributed annually it is to be regretted that more attention is not given to the accounts, for the purpose, at least, of showing by comparisons and proofs that there has been a reasonable return from the capital employed.

Building and Loan Associations.—The number of frauds—some of them of disastrous proportions—that have occurred in the accounts of building societies make the auditor of these accounts more than usually careful.

It will usually be found that the whole management of a building society devolves upon one man. Add to this the fact that the system of bookkeeping employed is generally of the most primitive kind, and some idea of the responsibility of the auditor's position may be gained. Any efficient system of internal check is all but unknown, while the class of men employed is usually very different and very inferior to the class of men employed in banks for work of a very similar nature.

The study of the reports of many associations can only convince an auditor of the extreme importance of checking every addition, posting, and voucher; of carefully verifying every amount received in redemption of mortgages or paid out to investing stockholders; of comparing *every* pass-book with the ledgers, and both with the lists of balances; and of testing the latter at considerable length in respect to the calculation of interest. The income received from properties on hand must be verified in every possible way; and, where such income does not seem to be a fair return upon the book value of the various

properties, the latter should be either revised or supported by independent valuation.

The papers relating to all mortgages, and the securities relating to whatever other investments there may be, must also be examined by the auditor, who will do well, in addition, to require an attorney to certify that such papers are all in order. It must also be remembered that there is usually a statutory limit to the borrowing powers of a society, which must not be exceeded.

Public Service Corporations.—The recent agitation in the United States with regard to municipal ownership of public utilities has aroused considerable interest in the methods of keeping the accounts of such utilities and preparing them for publication. So far municipal operation has not proved so successful as municipal ownership coupled with private operation through leases, and it is probable that the latter plan will prove more desirable for some time to come.

The day is probably not far distant, however, when all public service corporations, at least in the more populous States, will be under the supervision of a State Board, or Commission, empowered to fix rates and compel reports prepared along uniform lines. Many of our States have created these commissions, and it is safe to say that the rest will follow as the people demand it, and our legislators are alive to the fact that it makes possible enormous patronage. In New York State a single commission is spending more than a million dollars a year almost entirely in salaries and special compensation of various other kinds.

The most notable case of public regulation is that of the Interstate Commerce Commission, appointed under authority of Congress to supervise the operation of steam railways doing an interstate business. The results—so far as encouraging, and in some cases compelling, the keeping of and submitting accounts prepared along uniform lines—have been wonderfully successful, and part of the prosperity of our railways is no doubt attributable to the increased attention which has necessarily been given

to the accounting departments of the railway corporations which have been subject to this control.

In the fixing of maximum rates the Interstate Commerce Commission was for a long time impotent, and additional legislation has from time to time been required to enable anything of importance to be done along this line.

In the case of local public service corporations, however, State Legislatures can readily pass, and in some cases have passed, the necessary acts delegating to commissions or municipalities the power to fix rates.

This puts a responsibility on an auditor which is far more serious than when he is dealing solely with stockholders and other owners, for now he finds himself not only in the position of safeguarding the interests of the owners, but he also occupies a quasi-public position. The accounts to which he certifies should not be so conservative that the profits are unduly diminished and the public deceived; nor, on the other hand, should they be so lacking in proper reserves and depreciation allowances that the profits will appear too large, and the attention of the public consequently called to this fact, with the result that agitation for rate reductions naturally ensues.

Conclusion.—The continuous success of any enterprise depends upon its being conducted along lines of correct economic principles; its obedience thereto, or its departure therefrom can be discovered through the maintenance of correct accounting records; the public accountant is qualified to install such records and interpret them when established, and his experience and skill enable him to determine the causes which have produced the effect he considers and to advise thereon. Nevertheless, even in the very exceptional case of businesses where the system of accounting and the internal check are as perfect as may be, nothing can take the place of the independent external periodical review, and the necessity for it is founded in the very constitution of human nature. Intelligent criticism is beneficial to every one in every department of life. Without it people are prone to become

rusty and careless, and in the present day there is this very special reason, the safeguarding of the interests of those whose money is invested in an enterprise, but who can not, from the nature of the undertaking, take an active part in the management.

GLOSSARY

GLOSSARY

ABANDONMENT.—In marine insurance, the leaving of a dangerous or unseaworthy ship; in certain cases where damage is sustained, the exercise of the right of surrender of the insured property to the underwriters for the purpose of claiming the total insurance indemnity.

ABATEMENT.—A discount for overcharge or damages.

ACCEPTANCE.—In mercantile law, either the engagement to pay when due, on the part of one upon whom a bill of exchange is drawn, or the bill itself when it has been accepted. The method of accepting a bill is to write one's name across the face of it.

ACCOUNT RECEIVABLE.—A chose in action; an amount due from a debtor for goods sold, or services rendered.

ACCOUNTANT.—One skilled in balancing and keeping books, who is employed to prepare accounts and balance-sheets, and audit books and accounts, to see that they are properly kept, and that no fraud has been committed by the persons keeping them.

ACCRUED.—Accumulated since the last payment or receipt, up to a specified date.

ACCUMULATED DIVIDENDS.—Dividends not paid at the proper intervals remaining uncollected as a debt against the corporation which must be settled before a dividend can be distributed upon common stock.

ACCUMULATIVE DIVIDENDS.—Dividends which will accumulate if not paid regularly as they fall due, and will require payment before a dividend can be distributed upon the common stock.

ACTION.—Any civil proceedings instituted in a court of justice.

"ACT OF GOD."—A clause used in bills of lading to signify perils and dangers of the elements which are beyond human control.

ADJUDICATION.—The judgment of the court in any suit or other judicial proceedings.

ADMINISTRATOR.—One appointed to assume control over the estate of a person who has died intestate.

AFFIDAVIT.—A written declaration, upon oath, made before a person authorized to administer an oath.

AGENT.—One authorized to represent another, who is termed his principal.

ALLOCATE.—To assign or allot shares, items, or figures.

ALLONGE.—On bills of exchange, an attached slip for the signature of the indorser when there is no room on the bill itself.

AMORTISEMENT.—The extinguishment of a loan by single payment out of a special fund set apart for this purpose; or, the redemption of shares or bonds through annual drawings from a sinking fund.

ANNUITY.—A sum of money received or paid annually, for life or for a number of years.

APPRAISE.—To value with a view to a sale or loan.

APPURTENANCE.—Anything going with a piece of land when sold or rented, as conditional rights over adjoining land, a right of way, etc.

ARBITRATION.—The settling of disputed matters by the decision of one or more neutral persons nominated equally by the contending parties.

ARREARS.—Amounts remaining unpaid after the expiration of the proper time for paying them.

ARTICLES OF COPARTNERSHIP.—The documentary agreement of terms in the formation of a partnership.

ASSESSMENT.—A call upon its stockholders by a company to pay a certain sum into the treasury upon each share held, for the purpose of gathering extra funds to discharge debts or for working capital.

ASSETS.—Goods, estate, or other property available to pay debts, or represent capital.

ASSIGNMENT.—(a) A transfer of any personal property or right to another. (b) A failing debtor's transfer of his property to the assignee who administers it.

ATTACHMENT.—The legal seizure of property pending the settlement of some claim against the owner.

AUDIT.—An examination of the books and accounts for the purpose of verification, or detection of errors.

AWARD.—The finding of arbitrators on matters in dispute.

BAILMENT.—The delivery of goods to a person in trust on the understanding that they shall be returned upon the fulfilment of the purpose for which they were bailed.

BALANCE-SHEET.—A statement of assets, liabilities, and general condition of a business house.

BANKRUPTCY.—The condition of a debtor who has become unable to pay his creditors in full and has given up the whole of his property, through the courts, to be applied to the payment of his debts.

BARTER.—Exchange of goods without the employment of money or other medium of exchange.

BEAR.—One who depresses the market value of a stock by "selling short," in order to buy the same stock cheaper than he has sold it.

BENEFICIARY.—(a) One for whose benefit another holds the legal title to property. (b) In life insurance, the person to whom a policy is payable.

BILL OF EXCHANGE.—A written order upon the addressee to

pay a sum named therein to a third person specified at a time specified.

BILL OF LADING.—A documentary receipt given by a carrier for goods received in charge, with an agreement as to their transportation to a specified place.

BILL OF SALE.—A written statement of the sale of interest in personal property to another. The form of contract or the medium for the transfer of ships or ship shares.

BILLS PAYABLE.—Outstanding notes and legal paper held against a person or concern.

BILLS RECEIVABLE.—Incoming notes and legal paper to be paid to a person or concern.

BLANK INDORSEMENT.—The writing of one's name on the back of a negotiable instrument which does not contain the name of the person to whom it is payable.

BOND.—A deed by which a person binds himself to pay a sum of money or perform a certain act under certain conditions.

BUCKET-SHOP.—An unsound brokerage house where transactions take place purely on paper or gambling principles.

BULL.—One who buys stocks with the expectation of selling at a higher price. Opposite of bear.

BY-LAWS.—Private laws and orders for its own regulation made by a corporation or company.

CALL MONEY.—Borrowed money, with collateral security, which must be returned on the demand of the lender.

CAPITAL.—The total amount invested in a business and used or available to float and carry on the concern.

CAPITAL ACCOUNT.—The account carried on the books to indicate the amount of capital invested in a business.

CAPITAL STOCK.—The amount of share capital issued or authorized by a corporation.

CERTIFICATE OF STOCK.—A certificate issued by a corporation stating that so many shares of stock are owned by such and such a person.

CESTUI QUE TRUST.—One whose property is held for his benefit in trust.

CHARTER PARTY.—A contract in which the owner of a vessel hires her or part of her to another.

CHOSE IN ACTION.—The right to anything not actually in possession, which can be recovered by an action at law.

CHOSE IN POSSESSION.—Personal property actually in possession.

C. O. D.—"Collect on delivery."

COLLATERAL SECURITY.—Secondary indirect security in guarantee of the performance of a contract otherwise independent of it.

COMMON CARRIER.—A person or institution engaged in the business of transporting for hire goods or persons from one place to another.

COMMON LAW.—The ancient law of England, whose authority is based on old custom.

CONDITION PRECEDENT.—In an agreement, a clause necessitating the performance of some act by one party before the other party shall be liable, or to make him liable.

CONDITION SUBSEQUENT.—In an agreement, a clause referring to the occurrence of some future event upon which the obligation of the contract shall cease to be or become binding upon one of the parties.

CONSOLIDATED.—Applied to various funds bearing the same or different rates of interest which have been amalgamated into one common debt.

CONVERTIBLE SECURITIES.—Property which can be readily converted into cash.

CORPORATION.—A society or association authorized by law to act as a single individual with the right to perpetuate itself by the admission of new members.

COUPON.—A note of interest or dividend attached to a transferable bond: as it falls due it is cut off and presented for payment.

COVENANT.—A promise given within a sealed instrument, such as a warranty deed, a mortgage, or lease.

COVERTURE.—The status of a married woman before the law.

CREDIT.—(a) To give an account a drawing value. (b) The measure of a person's business reliability.

CURRENT ACCOUNT.—In banking, an account which may be withdrawn or added to at any time, with or without interest. In commercial practise a running account showing all transactions between the parties in interest.

DAYS OF GRACE.—A period of days (commonly three), granted by custom after the expiration of the period specified for the payment of notes and bills of exchange before they are finally payable.

DEBENTURE.—(a) A certificate for a loan to a railway or other corporation, having a lien on the real property and carrying a first charge on all the undertakings and assets of the concern, and therefore being entitled to the payment of interest before the share capital. (b) A certificate given by the custom-house to an exporter of excisable goods, entitling him to receive payment of the drawback allowed on such goods being exported.

DEBIT.—To charge anything to an account, or to make some direct charge upon a person.

DECREE.—The finding of an equity court.

DEED.—A sealed instrument agreeing to the conveyance of lands.

DEFICIT.—(a) A balance of liabilities over assets. (b) Excess of expenditure over income.

DEMISE.—The conveyance for life or a term of years of an estate in real property.

DEMURRAGE.—A charge of so much a day made by railroads and shipowners for the detention of their cars or ships beyond a specified time.

DEPRECIATION.—Deterioration in the value of assets through waste, wear or decay.

DEVIATION.—In marine insurance, any divergence from the terms and conditions specified in the policy of insurance, which thereby discharges the underwriter's risk.

DEVISE.—To bequeath by will.

DISAFFIRMANCE.—The rendering void of a voidable contract.

DISCOUNT A BILL.—To obtain money for a bill before it is due, paying interest for the accommodation.

DISHONOR.—To refuse to accept a bill, or to refuse to pay it when due.

DISTRAIN.—To seize goods for debt.

DIVIDEND.—(a) A periodical distribution of the profits of a corporation among the stockholders. (b) Any instalment paid to creditors out of the estate of a bankrupt.

DOCKET.—To indorse documents and letters with dates of receipt and reply and an epitome of contents.

DOMICILED BILL.—A bill not made payable at the residence or business place of the acceptor, but one upon which the place of payment is inserted at the time of acceptance.

DRAFT.—A bill of exchange: an order by which money is drawn from a bank.

DRAWN BONDS.—Bonds which have been drawn at one of the periodical drawings for payment on a certain date, after which all interest upon them ceases.

DURESS.—Compulsion or restraint upon one's free action.

EASEMENT.—A landowner's right to use another's land for a special purpose.

E. E. OR E. AND O. E.—Short for "Errors excepted," or "Errors and Omissions excepted," written by merchants at the foot of accounts, etc., so that they may legally correct any errors or omissions which may afterward be found.

EMBARGO.—(a) A government order preventing ships from loading or unloading certain goods, or from entering or leaving a port—a war measure. (b) An authoritative order to prevent the removal of property, pending legal proceedings against the owner.

EMBLEMENTS.—Growing crops representing outlay of labor and money.

EMINENT DOMAIN.—The right of the government to adopt private property for public uses.

ENTAIL.—To limit the descent of real property after its owner's death.

ENTREPOT.—An intermediate foreign warehouse or port for the temporary reception of goods in transit to another place.

ENTRY.—In customs, an action permitting the passage inward

or outward of goods, after they have been exactly described, and any duty required upon them paid.

ESCHEAT.—The reversion of property to the State owing to failure of heirs.

ESTOPPEL.—In law, a ruling to prevent a man from denying various conditions or facts as a result of his previous conduct or allegations.

EXCISE.—(a) An inland tax on articles produced and consumed in the country. (b) A duty levied for license to deal in or use certain articles, or to carry on certain professions and trades.

EXECUTED CONTRACT.—One whose purpose has been fulfilled, no obligation remaining upon either party.

FACTOR.—One whose powers exceed those of an agent in having the goods he sells in possession and in dealing in his own name when he buys or sells for a principal.

FEE SIMPLE.—An inheritance or estate without conditions and at the entire disposal of the owner.

FEE TAIL.—An entailed estate, descending in a special line.

FIXED ASSETS.—Assets which are stationary and virtually permanent; as machinery, buildings, and office furniture.

FIXED CAPITAL.—All commodities and fixtures employed in a business and those things which the owners only have the use of, or receive interest or rent upon; as buildings, tools, machinery, mills, etc.

FLOATING CAPITAL.—The available sum actually at command for carrying on a business: as money not permanently invested, accounts receivable, etc.

FLOATING DEBT.—(a) Ordinary indebtedness. (b) That part of an indebtedness not represented by a bond issue.

FLOATING POLICY.—A policy for a certain amount, insuring goods which are not all in one place but are spread over a certain district, so that the goods are covered either wholly or in part, according as their aggregate value may happen to be either more or less than the sum insured.

F. O. B.—"Free on board." Used in connection with shipments, to denote what proportion of carriage charges shall be paid by buyer or seller.

FORECLOSE.—To take possession of an estate or other property mortgaged; to secure repayment of a loan.

FOUNDERS' SHARES.—Shares granted to the founders of a company in consideration of their having floated the company, either by services in promotion or by defraying the preliminary expenses.

FRANCHISE.—Any privilege conferred by the government upon individuals.

FUND.—Any capital aggregation held for a specific employment.

FUNDED DEBT.—The part of a debt which is represented by bond issues payable at a specified distant date.

GILT-EDGED SECURITIES.—Securities of the highest type.

GOOD-WILL.—The connection and advantages accruing to a business house from its long establishment in a certain place, transferable with the property, or the value accruing to an established commodity.

GROUND RENT.—The rent paid to a landlord for the use (as for building) of his ground.

GUARANTY.—An engagement to be responsible for the default or debt of another person.

GUARDIAN.—One having custody over the person or property of a minor, an insane person, or any one not responsible before the law.

HERITABLE BONDS.—Bonds having a conveyance of law attached to them, given as a security for the faithful repayment of money owing.

HOME CONSUMPTION.—Consumption of goods and commodities in the country in which they are produced.

HONOR.—To meet a claim or obligation.

HYPOTHECATE.—To mortgage or pledge.

IMPOSTS.—Taxes, especially taxes on imports.

INCOME.—Gain proceeding from labor or property.

INDEMNITY.—Compensation for loss or injury sustained or to be sustained.

INDORSEMENT.—Signature on the back of a negotiable paper and the agreement to pay, if the chief debtor fails to pay, implied thereby.

INFANT.—In law, a male under twenty-one years, or a female (generally) under eighteen years.

INJUNCTION.—A writ of prohibition granted by a court of equity.

INSOLVENCY.—The state of being unable to pay the whole of outstanding debts.

INSURABLE INTEREST.—An interest in the object of the insurance of such a kind that the possessor of it may receive monetary injury from the risk attached to the insured object.

INSURANCE.—A contract to indemnify against a certain amount of loss from the occurrence of a specified contingency.

INTESTATE.—A person who dies without having made a valid will disposing of his property.

INVENTORY.—A list of all goods, fixtures, etc., appertaining to a given property, made for purposes of sale or reference in keeping accounts.

INVESTMENT.—Money sunk in the purchase of property or put out at interest in a fund or company.

INVOICE.—A specification in full of the quality, quantity, and price of goods, contents of and charges upon each package. It is sent to the purchaser by the manufacturer or trader when the goods leave the factory or store.

JOBBER.—A middleman between the manufacturer and the retail merchant.

JOINT STOCK COMPANY.—A form of partnership with some points of resemblance to a corporation (see pp. 43-44).

JOURNAL.—A daily record book for all transactions that can not be passed through other records of original entry, and for all transfers between accounts.

L. S.—Abbreviation for *locus sigilli*; place of the seal.

LANDLORD.—The owner or lessor of lands or buildings; also, an innkeeper.

LEAKAGE.—An allowance made for waste or loss in the transportation of liquids.

LEASE.—A documentary agreement to the use by another, for a term of years, of houses, buildings, or land.

LEDGER.—In bookkeeping, the chief book in use, containing a classification of all the transactions recorded in detail in the journal and other books of original entry.

LEGACY.—Property left to one by will.

LEGAL TENDER.—Authorized coins or other specie which may be legally offered in trade.

LETTER OF CREDIT.—A letter from a bank or mercantile house to agents or correspondents, domestic or foreign, requesting them to advance sums to the bearer and charge the same to the account of the writer.

LETTERS OF ADMINISTRATION.—A judicial instrument empowering some individual to settle the estate of one who has died intestate.

LETTERS TESTAMENTARY.—A judicial instrument empowering an executor of a will to fulfil the provisions of the will.

LIABILITIES.—The total sum of the debts of an individual or concern, together with any contingencies apt to arise from his or their pecuniary responsibilities.

LIEN.—A legal right to detain goods until the charges on them are defrayed or until some pecuniary claim against the owner is settled.

LIMITED.—When placed at the end of a company's name it signifies that the liabilities of such company are prescribed, or that it is one in which the shareholders are only liable for the subscribed amount of their shares.

LIQUID ASSETS.—Assets which are not fixed, but are either cash or subject to practically instantaneous conversion into cash.

LIQUIDATED DAMAGES.—Damages the amount of which has been agreed upon in advance.

LIQUIDATION.—The closing up of business transactions, or winding up of a business concern.

LIQUIDATION ACCOUNT.—An account opened at the time of liquidation, in which the credits consist of the profits realized from the assets, and the debits the expenses of liquidation and other liabilities not entered in the books.

MANIFEST.—A detailed account of a ship's cargo, sent by her owners or brokers to their agents abroad.

MARGIN.—A discretion of so much per cent or so much per share, allowed to work upon, over a named price, should it not be possible to do business at the price fixed.

MATURITY.—The date at which bills of exchange, promissory notes and the like fall due, or are legally payable.

MERGER.—The absorption of a contract in another contract.

MONOPOLY.—An exclusive right secured to one person or a group of persons to carry on some branch of trade or manufacture.

MORTGAGE.—A conveyance of property to a creditor for security of a debt.

NEGOTIABLE INSTRUMENTS.—Documents which may be freely transferred from one to another by indorsement and delivery, such as bills of exchange and promissory notes.

NET.—(a) The amount of any cost or charge when all deductions have been allowed for. (b) The actual amount where no deductions are allowed.

NET PROFITS.—The surplus remaining over from the employment of capital after all the expense and outlay incurred in its employment have been defrayed, and after the capital has been replaced or provision made for its replacement.

NOMINAL ACCOUNTS.—Accounts representing expenditures or income separately.

NOTARY PUBLIC.—One authorized to administer oaths, protest dishonored bills of exchange, and take acknowledgments.

NOTICE OF PROTEST.—A declaration in writing, made by a notary public, on behalf of the holder of a bill or note which has been refused payment, against other parties interested.

OPEN ACCOUNT.—An unbalanced or running account.

OPEN POLICY.—In insurance, a policy in which the value of the thing insured is not definitely fixed.

OPTION.—In the Stock Exchange, a manner of speculation in which a person pays so much per cent for the right to buy or sell so many shares, at a fixed price, on a specified day, thus limiting his possible loss or liability to a fixed amount. In commerce practise a privilege or provisional contract extended for a limited period.

OUTLAWED.—Barred by the statute of limitations; said of debts.

PAR.—The nominal value of securities. Stocks and bonds are said to be at par when they sell at their face value.

PAROL CONTRACT.—An agreement, as an oral agreement, not made under seal.

PARTNERSHIP.—The combination of two or more individuals to carry on a trade or business, the profits and losses to be shared in a manner agreed upon.

PARTY WALL.—A wall between two adjacent estates.

PAY-ROLL.—A record of the time of employees, or of the wages paid the same.

PERSONAL PROPERTY.—Movable possessions which are not attached to real property.

PETTY CASH.—Incidental expenditures, such as those for office supplies.

PLANT.—Permanent assets in manufacturing, considered collectively: buildings, ground, machinery, etc.

PLEDGE.—The delivery of goods in trust to another to fulfil an agreement or pay a debt.

POLICY.—A document containing a contract of insurance.

POLICY-HOLDER.—One who has under his control, or in his possession, an insurance policy.

POSTING.—The entering of credits and debits in a ledger.

POWER OF ATTORNEY.—A legal document empowering one person to sign and act for another.

PREFERENTIAL CREDITORS.—In the administration of estates, creditors whose debts are directed to be paid in priority to the claims of others.

PREFERRED STOCK.—Stock entitled to a fixed rate of dividend before anything is paid on the deferred or common stock.

PREMIUM.—(a) The annual payment made for insurance. (b) A sum paid in excess of nominal or par value.

PRIME COST.—The original or direct cost of an article, including raw material, freight inward and productive labor. It must be distinguished from the "cost of production," which in addition to the above includes all other expenses of manufacture.

PRINCIPAL.—(a) Money on which interest is paid. (b) The chief person of a firm. (c) One for whom another is authorized to act as agent.

PROFIT AND LOSS ACCOUNT.—An account exhibiting the excess of revenue over expenditure, the balance of which shows the net income, or vice versa.

PROMISSORY NOTE.—A written promise by one person to pay another person a certain sum of money, either on demand or at a specified time.

PROPRIETARY COMPANY.—Generally a parent company which owns a quantity of land suitable for mining and other purposes, which it sells or lets out in portions to other public companies.

PRO RATA.—In proportion.

PROTEST.—An attestation by a notary public of the demand and refusal to pay on a note or bill.

PROVISO.—A provision or condition in a deed or other document.

PROXY.—(a) One who acts for another. (b) A document in which one is authorized to act for another.

PUBLIC POLICY.—The policy according to which the law, acting for the good of the community, restricts the freedom of private contract.

QUIT-CLAIM DEED.—One having the character of a release.

QUOTATION.—The price and terms upon which a person is willing to enter an order.

RATE OF EXCHANGE.—The variable amount in the currency of one country which, at a given date, is offered a fixed sum in the currency of another country.

REAL ACCOUNT.—An account showing the value of actual assets, or the amount of the actual liabilities.

REAL ESTATE OR PROPERTY.—Immovable property, consisting of lands, houses, etc.

REBATE.—A discount or allowance, as that given for taking up bills of exchange before they are due.

RECEIVER.—One appointed by the courts to take and hold property in dispute, whether of an individual or a corporation.

REFEREE.—One to whom a matter in dispute is referred for decision.

REGISTERED STOCK.—Stock registered in the name of the holder at a bank or in the company's office where the stock was issued.

RELEASE.—A sealed instrument remitting a claim and extinguishing a debt.

REMITTANCE.—A sum of money sent, in any form, from one person to another.

RENT.—Remuneration for use of real estate or other property.

RESCIND.—To cancel or annul a contract or deed.

REVENUE EXPENDITURES.—Expenditures resulting from the immediate running expenses of a business.

REVENUE RECEIPTS.—Receipts directly resulting from the profits of a business.

RIDER.—(a) An addition to a document after its completion, on a separate piece of paper. (b) An additional clause to a verdict or resolution.

ROLLING STOCK.—In railway and street railway companies, all cars, engines, trucks, etc.

RUN ON A BANK.—A sudden or unusual demand for payment of deposits produced by fears that the bank is unable to meet its liabilities.

SALE.—A transfer of ownership rights of property for value received.

SALVAGE.—(a) Money paid to those who assist in saving a ship or its cargo from the dangers of the sea. (b) The goods thus saved. (c) Goods saved from fire on land.

SECURED CREDITOR.—A creditor who holds a security sufficient to cover the amount the debtor owes him.

SECURITY.—A document giving the holder a right to property not actually in his possession.

SELLING EXPENSE.—The expense of a business in commissions, salaries of salesmen, and other expenditures directly incident to the selling of goods.

SHARES.—The proportion of interest in any company or enterprise.

SHIP'S ARTICLES.—The conditions and terms, binding both master and seaman, to which seamen subscribe and agree to be bound when taking their places on the ship.

SIGHT BILL.—A bill of exchange payable at sight or as soon as presented.

SINGLE ENTRY.—A manner of keeping accounts without furnishing a trial balance or recording a debit for every credit, and therefore providing no more accurate check than that of calling back the entries.

SINKING FUND.—An appropriation set aside out of the profits of a corporation for extinguishing a debt, or an accumulative fund, raised by redeeming bonds and using the interest which would have been paid upon them for the purpose of future redemption, until the loan is extinguished.

SLEEPING PARTNER.—One who invests his money in a business without appearing by name in the firm and without taking active part in the work, while being liable in the same way as active partners.

SOLVENCY.—The state of being able to pay debts in full.

SPECIAL PARTNER.—One who invests his money in a partnership but is liable for its debts only up to the amount of his investment.

SPECIE.—Coined money of any variety.

SPECIFIC PERFORMANCE.—The full and precise performance of the terms of a contract.

SPECULATION.—The purchase of stocks or other property with the purpose of deriving profit from market fluctuations or variations in value.

STATUTE.—A legislative enactment.

STATUTE OF FRAUDS.—A statute intended to prevent perjury or fraud by necessitating certain contracts to be made in writing.

STATUTE OF LIMITATIONS.—A law which fixes the periods during which debts can be recovered.

STOCKHOLDER.—One who holds shares in a corporation.

STOPPAGE IN TRANSITU.—The stoppage of goods during their transit from one place to another: generally applied to the action of a seller of goods upon credit who has learned of the buyer's insolvency or bankruptcy. This is a legal right.

SUBPOENA.—A writ issued by a court of law summoning a person to appear at a day and place assigned, under a penalty for non-appearance.

SUBROGATION.—Substitution of one person or thing for another: specifically, of one person for another as creditor, with rights of succession.

SUBSIDY.—An aid in money given to another; especially, one granted by the State.

SURETY.—One who is legally bound, by a bond, to be (a) answerable for another's debt if it is not paid when due, or (b)

responsible for the performance of some duty undertaken by another.

SURPLUS.—The excess of assets over liabilities.

SUSPENSE ACCOUNT.—An account in which are contained all doubtful items, which from want of detail, or through death, clerical irregularity, oversight, etc., can not be posted in the regular books until such time as they can be finally adjusted and posted.

SYNDICATE.—A group of capitalists who associate for the purpose of carrying through a financial scheme by underwriting it.

TELLER.—In a bank, a clerk who receives or pays out money over the counter.

TENANT.—One who holds real estate under another by the payment of rent.

TENDER.—(a) An offer of money in payment of a debt. (b) A written offer to supply articles or commodities upon specified terms.

TENEMENT.—Any species of permanent property that may be held, so as to create a tenancy. Specifically, a building or suite of rooms in a building erected to be rented.

TENEMENT HOUSE.—A dwelling-house divided into apartments for separate families.

TESTATOR.—One who makes a will.

TONNAGE.—The number of tons a ship is capable of carrying.

TRADE DISCOUNT.—The deduction from list prices allowed to jobbers or others.

TRADE-MARK.—A device placed upon his articles by a manufacturer to distinguish his make from that of similar articles produced by competitors.

TREASURY STOCK.—Issued, outstanding stock which has been purchased by or donated to a corporation and is held subject to disposal by the directors.

TRUSTEE.—One appointed by law or will to manage the property of another.

TURNOVER.—The total amount of money that has been traded upon by buying and selling during a certain period.

ULTRA VIRES.—"Beyond its powers"; applied to any acts of a corporation beyond those mentioned in the charter.

UNDERWRITER.—An insurer.

USUFRUCT.—The right to use for a time something belonging to another, without diminishing or altering its substance in any manner.

VERDICT.—The decision of a jury on a trial after hearing the evidence of both sides.

VOUCHER.—A document certifying the correctness of charges for values paid out or of credit for values received.

WARRANT.—A receipt for goods which have been deposited in a warehouse, with all particulars necessary to identify the particular parcels for which the warrant is issued.

WARRANTY.—(a) In insurance, the declarations signed by the insured which, if incorrect or not complied with, render the policy void. (b) An agreement to hold oneself responsible if a certain thing does not turn out as represented.

WASTING ASSETS.—Fixed assets which in the process of working gradually decrease, as quarries, mines, etc.

WATERED CAPITAL.—(a) Capitalization greater than the actual cost of duplicating the property. (b) Capital not actually paid in in the form of cash.

WATERED STOCK.—New stock created to increase the capital of the company without the making of any additional provision for paying dividends. Stock issued in excess of actual values but depending upon possible future values.

WILL.—A written disposal of one's property to take effect after one's death.

WORKING CAPITAL.—The available sum actually at command for carrying on a business: as money not permanently invested, and free cash.

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